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T. C. Memo. 1986-270

UNITED STATES TAX COURT

JOHN R. KORSMAN, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 483-84. Filed July 2, 1986.

Alfred J. O'Donovan, III, for the petitioner.

Anthony A. Falzone, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: The Commissioner determined deficiencies in petitioner's Federal income tax liability as follows:

Taxable Year	Deficiency
1979	$12,420.41
1980	8,569.08
1981	8,137.48

After concessions by the parties, the remaining issue is whether petitioner, a commercial airline pilot, is entitled to deduct operating costs and depreciation incurred due to his ownership of a private airplane as deductible educational expenses under section 162.[1] We must also decide whether petitioner is entitled to claim an investment tax credit with respect to this airplane.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts and the attached exhibits are incorporated by this reference.

John R. Korsman (petitioner) filed his Federal income tax returns for the taxable years 1979, 1980, and 1981 with the Internal Revenue Service Center at Andover, Massachusetts. At the time he filed his petition in this case petitioner resided in Mason, New Hampshire.

Petitioner is a veteran commercial pilot for Delta Airlines (Delta) flying out of Logan International Airport in Boston, Massachusetts. He was first employed in the airline industry in 1954 when he was hired as a mechanic with Northeast Airlines (Northeast). Subsequently, he was trained as a flight engineer. Later, when Northeast implemented a requirement that all of its flight engineers be licensed pilots, it provided training to petitioner so that he could become a licensed commercial pilot.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the taxable years in issue, and all rule references are to this Court's Rules of Practice and Procedure.

After receiving his pilot's license he was promoted by Northeast to the position of co-pilot and served as a member of the flight crew on different types of aircraft. In 1967, he received his first assignment as a captain of a passenger airplane. Later, petitioner began flying the Boeing 727, which is powered by three jet engines and has the capacity to carry approximately 137 passengers. He continued to serve as captain of Boeing 727 aircraft after the merger of Northeast into Delta in 1972.

During the years in issue, petitioner flew as captain for Delta approximately 75 hours per month. Petitioner did not always fly on a regular schedule. At times during his career petitioner flew "reserve," meaning he was required to be available to fly on very short notice in the event the pilot scheduled to fly a route was unable to do so because of illness or otherwise.

Delta provided petitioner all of the training required by the Federal Aviation Administration (FAA) to maintain his proficiency as captain of a commercial jet. This training included semi-annual testing on flight simulators, which recreate actual flight conditions in a mock-up of an airplane cockpit. Before petitioner could fly a airplane on a route over which he had not flown as a commercial pilot, Delta was required by the FAA to educate petitioner regarding any special characteristics of the route. For safety reasons, it is important that a commercial pilot be familiar with the layout, surrounding terrain, the traffic control procedures, and the particular requirements for an approach under instrument flying rules (IFR). The FAA regulations in effect prior to August 31, 1980, required that each airline qualify its pilots before they fly a route by making a qualifying entry into any new airport as follows:

> The qualifying pilot shall make an entry as a member of a flight crew at each regular, provisional, and refueling airport into which he is scheduled to fly. The entry must include a landing and a takeoff. The qualifying pilot must occupy a seat in the pilot compartment and must be accompanied by a pilot who is qualified for the airport.

A pilot did not need to make a qualifying entry into a new airport if the airline familiarized the pilot with approved pictorial means.

On May 11, 1978, the FAA announced proposed changes to its regulations regarding the qualification of pilots for new routes. The proposed regulations, which became effective as final regulations on August 31, 1980, generally eliminated the requirement that each pilot make a physical entry into each airport for which he was to be qualified. Delta was still required to familiarize a pilot with the characteristics of any route before the pilot was called upon to carry passengers over the route. However, a physical qualifying entry or qualification by pictorial means was still required where entry into the airport was unusual due to surrounding terrain or obstructions, or complex approach or departure procedures. Delta regularly used flight simulators to qualify its pilots to land at new airports.

On August 31, 1979, petitioner purchased a Cessna 185 II Skywagon airplane for $54,500 plus shipping costs of $440 from Fitchburg Colonial Aviation, Inc., in Fitchburg, Massachusetts. The Cessna 185 II Skywagon (Cessna 185) is a single-engine, propeller driven airplane, which seats from one to six persons. The Cessna 185 was equipped with much of the same basic instrumentation as the Boeing 727's petitioner flew in his employment with Delta, including the equipment for navigation under IFR.

The Cessna 185 was delivered to petitioner at the Fitchburg, Massachusetts airport, which is near his home in Mason, New Hampshire. Shortly thereafter, he made several short flights in the plane accompanied by a trained flight instructor. These flights were necessary in order for petitioner to be "checked-out" in the operation of the airplane to satisfy the requirements of the company insuring the plane. Petitioner flew the airplane locally 16 times from September 3, 1979, to January 16, 1980, often landing at small airports in the vicinity, but always returning to Fitchburg the same day.

On January 21, 1980, petitioner began the first of three cross-country trips in the Cessna 185. Petitioner was accompanied by his son, a licensed pilot who owned his own small airplane. The trip began from Fitchburg and terminated on January 25, 1980, at San Martin, California. Petitioner's son lived nearby with his mother and step-father. Petitioner and his son made several stops along the way as follows: Frederick, Maryland, Louisville, Kentucky, Tulsa, Oklahoma, Lubbock, Texas, El Paso, Texas, Blythe, California, San Jose, California, and San Martin, California.

After spending a short time in California during which he visited his daughter, petitioner returned home via a commercial airliner. Petitioner did not fly the Cessna 185 again until July 1980. In the interim, petitioner's son flew the airplane frequently for purely personal reasons. During this time the airplane was parked at South County Airport in San Martin, California.

On July 10, 1980, petitioner's son flew the Cessna 185 from San Martin to San Jose where he met petitioner. From San Jose petitioner and his son began a 3-day cross country trip to Fitchburg stopping along the way at Salt Lake City, Utah, Cheyenne, Wyoming, Des Moines, Iowa, and South Bend, Indiana.

During the next month, petitioner made several flights in the general vicinity of Fitchburg. During these trips petitioner would typically land at one or more small airports before returning to Fitchburg. Trips from Fitchburg to Manchester, New Hampshire, on July 18 and August 4, 1980, were for the purpose of having repairs made to the equipment of the Cessna 185. Then, on August 23, 1980, petitioner and his son set out again for California in the Cessna 185 making stops at South Bend, Des Moines, Cheyenne, and Salt Lake City.

Shortly after this trip, petitioner returned home again, leaving the Cessna 185 with his son. During the next 10 months, petitioner's son was the only person to fly the Cessna 185. He flew the airplane several times for his personal enjoyment. Petitioner did not fly the airplane again until June 11, 1981, when he flew from San Martin to Reno, Nevada, for 3 days. With the exception of one 3-day trip in the Cessna 185 by petitioner and his son to Las Vegas, Nevada, petitioner's son continued to be the only person to use the plane until he ferried the airplane back to Fitchburg in October 1981. For the last three months of the taxable year 1981, petitioner only flew the Cessna locally, landing at various small airports.

Many of the airports into which petitioner flew the Cessna 185 were in cities into which Delta flew regularly scheduled flights. However, other airports flown into by petitioner in the Cessna 185 were physically incapable of accomodating any of Delta's passenger jet fleet due to factors such as runway length. Others were simply not served by Delta at the time. The following tables list all the cities to which petitioner flew to in the Cessna 185, whether Delta provided service to that airport during the taxable years in question, and whether one or more of the jet airplanes in Delta's fleet could make a regular non-emergency landing at these airports:

Airports Flown to by Petitioner in Cessna 185 at which Delta Fleet could not land

Fitchburg, MA
Gardner, MA
Nashua, NH
Keene, NH
Pepperell, MA
Frederick, MD
Tewksbury, MA
San Martin, CA

Airports Flown to by Petitioner in Cessna 185 that were capable of being served by Delta

Airport	Delta Service
Worchester, MA	No
Sterling, MA	No
Manchester, NH	No
Louisville, KY	No
Tulsa, OK	Yes
Lubbock, TX	No
El Paso, TX	No
Blythe, CA	No
San Jose, CA	No
Salt Lake City, UT	Yes
Cheyenne, WY	No
Des Moines, IW	No
South Bend, IN	No
Windsor Locks, CT	No
Reno, NV	Yes
Las Vegas, NV	Yes

Petitioner was unfamiliar with the approaches and landings required at most of the airports visited on his cross country trips with his son. He had, however, previously landed commercial planes at Manchester, Windsor Locks, and Louisville.

After enactment of the Airline Deregulation Act of 1978, many airlines expanded service into new cities while terminating less profitable routes. Delta made schedule changes after the taxable years in issue attributable in part to the deregulation of the commercial aviation industry. With regard to the cities into which petitioner flew in the Cessna 185, Delta ceased serving Reno, but initiated service to El Paso, Lubbock, and Louisville. Delta previously served Worchester, Massachusetts, and Manchester, but ceased flying to those cities prior to the years in issue.

None of petitioner's landings and takeoffs in the Cessna 185 constituted qualifying entries for the purposes of the pilot qualification required under FAA regulations. Further, the purchase and operation of the Cessna 185 by petitioner were not necessary to meet requirements of Delta or the requirements of applicable law or regulations imposed as a condition to the retention by petitioner of his employment or to his rate of compensation.

Petitioner could have conducted his independent familiarization plan by means other than by purchasing and flying a private plane such as the Cessna 185. First, he could have familiarized himself with airports serviced by Delta via employer provided training consisting of actual physical entries into these airports or flight simulation. Second, petitioner could have observed approaches, landings, and takeoffs from the extra seat in the cockpit available to Delta personnel known as the "jumpseat." Although Delta restricted the availability of this seat for its off-duty pilots, and other persons including FAA personnel had priority in its use, petitioner attempted unsuccessfully to ride in the cockpit "jumpseat" on no more than two or three occasions. Lastly, petitioner could have rented an airplane rather than purchasing his own plane.

On his Federal income tax return for the taxable year 1979 petitioner claimed employee business expenses including costs of operating the Cessna 185 totaling $11,728.47. In his statutory notice of deficiency the Commissioner disallowed the expenses claimed by petitioner with regard to the Cessna 185 for the taxable year 1979 as follows:

	1979
Fuel and additives	$ 511.22
Insurance	1,140.00
Inspection	92.09
Registrations	15.00
Manuals	146.43
Repairs	146.43
Windshield cover	49.95
Parts	18.95
Rent	90.00
Shipping	440.00
Depreciation	8,175.39
Interest	903.01
	$11,728.47

The Commissioner also disallowed the investment tax credit in the amount of $5,722.77 claimed by petitioner in connection with the purchase of the Cessna 185.

Similarly, for the taxable years 1980 and 1981 the Commissioner disallowed the employee business deductions claimed in connection with the operation of the Cessna 185 as follows:

1980

Fuel	$ 2,468.16
Insurance	1,225.00
Tie Downs	383.00
Inspections	742.53
Depreciation	8,216.39
Interest	1,457.83
	$14,492.91

1981

Fuel	$ 763.50
Insurance	1,567.00
Tie Downs	405.00
Inspections	617.40
Property Tax	564.74
Professional dues	944.87
Repairs	342.11
Depreciation	8,257.39
FAA Medical	85.00
Interest	106.78
Mathematical error	(84.15)
	$13,569.64

The Commissioner allowed petitioner an itemized deduction for the taxable years in issue for all of the interest expense for which an employee business expense deduction was denied. The Commissioner disallowed an investment tax credit of $8 claimed by petitioner in 1980 in connection with the purchase of equipment for the Cessna 185. Petitioner concedes that the amount claimed as a deduction for "shipping" is properly added to the tax basis of the airplane.

OPINION

After concessions by the parties, the issues before us concern the deductibility of expenses of operation, including depreciation, and the availability of investment tax credit arising out of the purchase and operation of petitioner's airplane. Petitioner claims that he purchased the airplane to familiarize himself with airports currently served by Delta or to which Delta might expand service and to which he might be called upon to fly. Therefore, petitioner contends that the expenses of operating the plane are deductible under section 162 because those expenses constitute deductible education expenses. Similarly, petitioner contends that he is entitled to claim depreciation deductions and an investment tax credit with respect to the airplane because by undertaking his alleged familiarization program he was using the airplane in his trade or business.

Section 162(a) allows a deduction for "all the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business." Education expenses are deductible only if the requirements of section 162 and section 1.162-5, Income Tax Regs., are met. Otherwise expenditures made for education are nondeductible personal expenses. Sec. 1.262-1(b)(9), Income Tax Regs.

Even if we assume that the expenses of operating the Cessna 185 are "ordinary and necessary" within the meaning of section 162, educational expenses are deductible only if the education:

> (1) Maintains or improves skills required by the individual in his employment or other trade or business, or
>
> (2) Meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation. [Sec. 1.162-5(a), Income Tax Regs.]

Inasmuch as neither Delta nor the FAA required petitioner to conduct his independent airport familiarization program, petitioner's claimed deductions for the operating expenses for the Cessna 185 are deductible only if the familiarization program maintained or improved skills actually required in his employment with Delta.

Whether education maintains or improves skills required in the taxpayer's employment is a question of fact. Boser v. Commissioner, 77 T.C. 1124, 1131 (1981), revised 79 T.C. II, affd. by unpublished order (9th Cir. 1983); Baker v. Commissioner, 51 T.C. 243, 247 (1968). The burden of proof is on the taxpayer. Welch v. Helvering, 290 U.S. 111 (1933); Wassenaar v. Commissioner, 72 T.C. 1195, 1199 (1979); Rule 142(a). The fact that petitioner's education is in some way helpful to him in the performance of his duties as an employee does not establish that its cost is deductible as a business expense. Carroll v. Commissioner, 51 T.C. 213, 215 (1968), affd. 418 F.2d 91 (7th Cir. 1969). Petitioner must show that there was a direct and proximate relationship between his airport familiarization program and the skills required in his employment as a pilot for Delta. Kornhauser v. United States, 276 U.S. 145, 153 (1928); Boser v. Commissioner, supra. A precise correlation between the education and the skills required in petitioner's employment is not necessary. Boser v. Commissioner, supra; Schwartz v. Commissioner, 69 T.C. 877, 889 (1978).

After our review of the record in this case, we are not satisfied that petitioner has demonstrated a direct and proximate relationship between his airport familiarization program and skills actually required of him in the performance of his duties as a pilot for Delta. For this reason, all of the costs of operating the Cessna 185 during the years in issue represent nondeductible personal expenses. Sec. 262.

Petitioner is a long time flying enthusiast. He is also an experienced professional pilot. He does not contend that operation of the Cessna 185 improved his basic skills as a commercial pilot, including landings and takeoffs under IFR. He has served as pilot in command of commercial aircraft since 1967 and he regularly flew close to 75 hours per month as a Delta pilot during the taxable years in issue. This case, therefore, is distinguishable from the situation where a pilot is unable to maintain or improve necessary flying skills in the course of his employment. See Boser v. Commissioner, supra. Nor does petitioner contend that the purchase of the Cessna 185 was necessary to practice approaches, landings, and takeoffs at airports about which he was already knowledgeable and to which he previously flew as a Delta or Northeast pilot. Petitioner merely contends that he purchased the Cessna 185 in order to familiarize himself with specific flying conditions in and around cities to which Delta presently flew or where Delta might expand service and to which he might be called upon to fly in the future. This argument relies wholly upon the uncorroborated speculation of petitioner and does not meet his burden of proof.

Petitioner had no demonstrable basis for concluding that Delta would expand to some of the cities he visited on his cross-country trips. He presented no documentary evidence or testimony to corroborate his vague speculation about future expansion by Delta in light of the deregulation of the airline industry. Furthermore, even assuming expansion by Delta into new markets, petitioner did not demonstrate any likelihood that he would be called upon to fly to airports outside the Northeast section of the country with which he was not familiar.

At the time he incurred the expenses at issue, familiarity with the characteristics of the approaches, landings, and takeoffs at airports to which he could not expect to be called upon to fly was simply not a skill required in his employment. Ultimately, petitioner did pilot Delta passenger aircraft to some of the cities he visited on his familiarization tours, but his unsupported speculation about his future duties as a Delta employee cannot convert what are essentially personal expenses incurred in the course of cross-country and local air travel, as well as the purely personal use of the airplane by his son, into deductible business expenses.

We do not doubt that a physical entry into an airport with which he was unfamiliar would be helpful in the event he was later required to pilot a commercial airplane to that location.

The fact that the FAA no longer requires physical entries into airports, standing alone, does not prevent us from finding that petitioner's familiarization program maintained or improved skills required in his employment. However, we do not ignore the fact that Delta could not call upon him to fly to a new city without first assuring that petitioner was cognizant of any special characteristics of the route under their qualification program, regardless of petitioner's independent efforts. In this regard, we give no credence to petitioner's self-serving suggestion that he decided to go beyond the training required of him by Delta and the FAA because he is more conscious of the safety of his passengers than his fellow professional pilots. We simply find that, absent a reasonable expectation that he would be called upon to fly to cities visited by him in the Cessna 185 in the course of his employment, petitioner's efforts to familiarize himself with the various airports were not directly and proximately related to his employment.

We point out again that our finding on this issue is a factual one. Happily for petitioner, his avocation and his vocation merge to some degree. Such a merger of hobby and occupation can create difficulty in separating personal nondeductible expenses incurred in an activity from those that are deductible. In this case petitioner has not borne the burden placed upon him to prove his entitlement to any deduction.

Because we find that the operation the Cessna 185 was not directly and proximately related to petitioner's employment and, therefore, that it did not maintain or improve skills required in his employment, we need not address respondent's alternative arguments that the expenses were not ordinary or necessary or that petitioner failed to substantiate those expenses. Our conclusions regarding the operating expenses also resolve the questions concerning the availability of the depreciation deductions and investment tax credit claimed by petitioner. Based upon our conclusion that petitioner's cross-country and local flights were personal and not made as part of his trade or business, it follows that the Cessna 185 was not property used in the trade or business within the meaning of section 167(a)(1). Therefore, the airplane is not property subject to depreciation. Furthermore, because of the requirement of section 48(a)(1) that "section 38" property must be subject to depreciation, no investment credit is allowable with respect to the Cessna 185. Sec. 38(a).

Decision will be entered
under Rule 155.

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T. C. Memo. 1986-271

UNITED STATES TAX COURT

JANET E. BOWERS, Petitioner v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 27381-84. Filed July 3, 1986.

Lawrence M. Hill, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined the following deficiency and additions to tax in petitioner's Federal income taxes:

		Additions to tax		
Year	Deficiency	Sec. 6653(b)(1)[1]	Sec. 6653(b)(2)	Sec. 6654
1982	$5,220.54	$2,840	50% of the interest due on $5,220.54	$452.35

The issues for decision are:

(1) Whether we should grant respondent's unopposed motion to dismiss for lack of prosecution;

(2) Whether petitioner is liable for the addition to tax under section 6654;

(3) Whether petitioner is liable for the addition to tax under section 6653(b); and

(4) Whether damages should be awarded to the United States under section 6673.

FINDINGS OF FACT

Janet E. Bowers (petitioner) resided in Orange, Virginia when she filed a timely petition in this Court. Her petition alleged, among other things, the following:

(1) That she is not a "person" within the meaning of section 7701(a);

(2) that respondent's notice of deficiency is illegal and founded on fraud and fraudulent interpretation and application of the law by the Commissioner;

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue.

(3) that the Commissioner violated the publishing requirements of the Federal Register;

(4) that the Commissioner materially and wilfully misrepresented the factual requirements of the Privacy Act of 1974;

(5) that the Commissioner erred in determining that the labor petitioner performed during the 1982 taxable year was not "property"; and

(6) that the Commissioner erred in determining that the Internal Revenue Code required petitioner to file a tax return.

This case was regularly called for trial at the trial session of this Court on May 28, 1985, in Washington, D.C. Although counsel for the Commissioner entered his appearance, no appearance was made by or on behalf of petitioner. All of the material allegations set forth in the petition in support of the assignments of error have been denied by respondent in his answer. Furthermore, petitioner has not adduced any evidence in support of the assignments of error raised in her petition. Petitioner was uncooperative with respondent throughout the period of this litigation and has failed to comply with this Court's Rules of Practice and Procedure that require the parties "to stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached." Rule 91(a).[2] On May 29, 1985, respondent filed a motion to dismiss for failure to properly prosecute.

In his amended answer to the petition, respondent made the following affirmative allegations regarding the section 6653(b) addition to tax for fraud:

> FURTHER ANSWERING the petition, respondent alleges the following in support of the fraud penalty for taxable year 1982 as set forth in the notice of deficiency with respect to the petitioner:
>
> a. At the time of the due date for filing of the tax return for 1982, petitioner had experience with filing income tax returns.
>
> b. At the time of the due date for filing of the tax return, petitioner was intelligent and of sound mind.
>
> c. At the time of the due date for filing of the tax return, petitioner had obtained a sufficient level of education to understand the obligation to pay federal income taxes and to file income tax returns.
>
> d. Petitioner failed to file income tax returns or to pay federal income taxes during 1982 with the intent to evade taxes known to be due.
>
> e. Petitioner filed false Forms W-4 during 1982 with the intent to evade taxes.
>
> f. Petitioner filed a bogus claim for refund with the intent to fraudulently evade the payment of taxes during 1982.
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> g. Petitioner refused to cooperate with the Internal Revenue Service during the examination by refusing to respond to questions or produce books or records when requested to do so.

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[2] Unless otherwise indicated, all rule references are to the Tax Court Rules of Practice and Procedure.

h. Petitioner failed to file a return during 1982 or to pay income taxes known to be due with the intent to defeat or evade the payment of income taxes.

i. For each respective year, all or part of the underpayment of tax is due to fraud.

Petitioner failed to reply to the affirmative allegations and respondent thereupon moved for entry of an order that they be deemed admitted pursuant to Rule 37(c). Because no reply was received as required by Rule 37(a) and (b), we entered an order dated June 3, 1985 granting respondent's Rule 37 motion. We further ordered that the affirmative allegations of fact set forth in paragraphs 27(a) through 27(i) of respondent's amended answer be deemed admitted for purposes of the instant case.

OPINION

Petitioner has the burden of proof with respect to the deficiency in tax determined and with respect to the addition to tax under section 6654. Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933). She filed a petition replete with frivolous and groundless assertions, and has made no attempt to rebut the determination of deficiency found in respondent's statutory notice of deficiency. As we indicated above, when this case was called for trial, no appearance was made by or on behalf of petitioner. Rule 123 provides that a party may be held in default if she fails to comply with the Rules of this Court, and that an issue may be decided adversely to a party who fails to present and prosecute her case. Accordingly, we grant respondent's motion to dismiss for lack of prosecution. Rule

123; see also Rule 149(b); Gilday v. Commissioner, 62 T.C. 260, 261 (1974).[3] Therefore, as to both the deficiency and the section 6654 addition to tax, we sustain respondent's determinations.

We must next consider whether petitioner is liable for the section 6653(b) additions to tax for fraud. Respondent has the burden of proving by clear and convincing evidence that an underpayment exists, and that part of the underpayment for each year was due to fraud. Section 7454(a); Rule 142(b). This burden is met if it is shown that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968). The affirmative allegations of fact set forth in respondent's amended answer are sufficient to establish that petitioner earned wages and failed to report them as income or to pay the taxes due on them. The existence of an underpayment for the year in issue is therefore clearly established. What remains for our decision is whether any part of the underpayment for the year in issue was due to fraud.

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud will never be presumed. Beaver v. Commissioner, 55 T.C. 85, 92 (1970). Fraud may however, be proven by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otsuki v. Commissioner, 53 T.C. 96, 105-106 (1969).

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[3] See also Gellatly v. Commissioner, T.C. Memo. 1984-262; Ramsey v. Commissioner, T.C. Memo. 1984-251.

This Court has previously held that the burden placed upon the Commissioner to establish a taxpayer's fraud can be satisfied through those facts deemed admitted and conclusively established pursuant to Rule 37(c). In Doncaster v. Commissioner, 77 T.C. 334 (1981),[4] we said:

> It is clear from the foregoing that a petitioner cannot, by total and continued silence, ensure that he will not be considered as having, in effect, conceded his case. The fact that * * * [these allegations] are worded in conclusory language does not require a different conclusion. They were "specified allegations" within the meaning of Rule 37(c); in our judgment, their deemed admission more than satisfies the respondent's burden of proof. * * * We are reinforced in our conclusion by the numerous holdings that fraud is a question of fact--albeit an ultimate question of fact. * * * [Doncaster v. Commissioner, supra at 337. Citations omitted.][5]

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[4] See Corbitt v. Commissioner, T.C. Memo. 1984-586; Miller v. Commissioner, T.C. Memo. 1983-476; Hindman v. Commissioner, T.C. Memo. 1983-389.

[5] We note that respondent has the burden of proving the facts necessary to establish an underpayment and may not rely upon petitioner's failure to produce evidence in order to carry his burden. Doncaster v. Commissioner, 77 T.C. 334, 337-338 (1981).

Here the material factual allegations in respondent's amended answer have been admitted and conclusively establish the following:

1) Petitioner knew and understood her obligation to pay Federal income taxes.

2) Petitioner refused to cooperate with respondent during the examination of her return by refusing to produce her books and records.

3) Petitioner filed a false W-4 form for the year in issue.

4) Petitioner failed to file a Federal income tax return or pay the taxes due for the year in issue.[6]

As a consequence of filing false withholding statements, petitioner rendered the withholding mechanism inoperative. Combined with her failure to file a tax return, petitioner effectively evaded payment of the income tax she owed for the year in issue. While failure to file a return is not by itself conclusive evidence of fraud, it is a factor worthy of consideration, especially when coupled with the submission of a false W-4 Form. Rowlee v. Commissioner, 80 T.C. 1111, 1124-1125 (1983); Habersham-Bey v. Commissioner, 78 T.C. 304 (1982). In addition, by failing to cooperate with respondent in producing her books and records, petitioner forced respondent's agents to determine the sources and amounts of her income. Hebrank v. Commissioner, 81 T.C. 640, 642-43 (1983), affd. per order (11th Cir., Mar. 26, 1985).

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[6] We also note that respondent introduced a copy of petitioner's W-2 statement for 1982 which indicated that she earned $23,761.91 in taxable wages for the year 1982.

In our judgment, these facts as well as those set forth above clearly and convincingly establish fraud with intent to evade tax. Therefore, we hold that respondent has carried his burden of proof with regard to the section 6653(b) addition to tax for fraud.[7]

Finally, we must decide whether damages should be awarded under section 6673. Section 6673, as amended, and as applicable to this case, provides as follows:

> Whenever it appears to the Tax Court that proceedings before it have been instituted or maintained by the taxpayer primarily for delay or that the taxpayer's position in such proceedings is frivolous or groundless, damages in an amount not in excess of $5,000 shall be awarded to the United States by the Tax Court in its decision. Damages so awarded shall be assessed at the same time as the deficiency and shall be paid upon notice and demand from the Secretary and shall be collected as a part of the tax.

When this Court, in its discretion, determines that a proceeding has been instituted or maintained primarily for delay or that a taxpayer's position in a proceeding before this Court is frivolous or groundless, damages of up to $5,000 can be awarded to the United States.

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[7] See Marshall v. Commissioner, 85 T.C. 267 (1985) (respondent's burden of proof sustained through facts deemed admitted pursuant to Rule 90(c)).

We conclude on the record in this case that petitioner's position in this proceeding is both frivolous and groundless and that this proceeding was instituted by her primarily for delay. Petitioner failed to appear when her case was called for trial and has never addressed the substantive issues in this case which relate to the correct determination of her income and deductions for the year in issue. Instead, petitioner has asserted that she is not a "person" for purposes of the Internal Revenue Code and that her labor constitutes "property." Such naked assertions involve frivolous, discredited and meritless issues that have resulted in a needless delay in this proceeding, and the unwarranted waste of valuable governmental and judicial resources. Cf. Abrams v. Commissioner, 82 T.C. 403 (1984); McCoy v. Commissioner, 76 T.C. 1027, affd. 696 F.2d 1234 (9th Cir. 1983); Wilkinson v. Commissioner, 71 T.C. 633 (1979).

Petitioner of course had every right to contest respondent's allegations with regard to the section 6653(b) addition to tax for fraud, and exercising or failing to exercise this right can not be a basis, either alone or in conjunction with other facts, for imposing damages pursuant to section 6673. But petitioner's frivolous allegation in her petition, coupled with her obvious indifference to the prosecution of her case, are evidence that this proceeding was instituted primarily to delay the payment of her taxes. She was advised by respondent that an award for damages would be requested and she was provided with cases clearly demonstrating the frivolous nature of her position. Furthermore, we note that petitioner has been before this Court on a prior occasion where we saw fit to award damages to the United States pursuant to section 6673. In these circumstances, we think damages in the amount of $5,000 are appropriate and, therefore, damages in that amount will be awarded to the United States under section 6673.

An appropriate order and decision will be entered.

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T. C. Memo. 1986-272

UNITED STATES TAX COURT

DONALD L. BOWERS, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 27380-84. Filed July 3, 1986.

Lawrence M. Hill, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, Judge: Respondent determined the following deficiencies and additions to tax in petitioner's Federal income taxes:

		Additions to Tax		
Year	Deficiency	Sec. 6653(b)(1)[1]	Sec. 6653(b)(2)	Sec. 6654
1981	$9,374.23	$4,755	—	$715.71
1982	5,446.00	2,733	50% of the interest due on $5,446	530.21

The issues for decision are (1) whether petitioner is liable for the additions to tax under section 6653(b)(1) and (2) whether damages should be awarded to the United States under section 6673.

FINDINGS OF FACT

Donald L. Bowers (petitioner) resided in Orange, Virginia, when he filed a timely petition in this Court. His petition alleged, among other things, the following:

(1) That petitioner is not a "person" within the meaning of section 7701(a);

(2) that respondent's notice of deficiency is illegal and founded on fraud and fraudulent interpretation and application of the law by the Commissioner;

(3) that the Commissioner violated the publishing requirements of the Federal Register;

(4) that the Commissioner materially and wilfully misrepresented the factual requirements of the Privacy Act of 1974;

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue.

(5) that the Commissioner erred in determining that the labor petitioner performed during the 1981 and 1982 taxable years was not property; and

(6) that the Commissioner erred in determining that the Internal Revenue Code required petitioner to file a tax return.

Petitioner was ordered to pay the filing fee of $60 on or before November 30, 1984. He refused to pay it despite an informal request on September 11, 1984, and the Court's order dated October 29, 1984. As a result of petitioner's unwillingness and failure to pay the filing fee, the Court entered an order dated February 12, 1985, dismissing the case insofar as it pertains to those issues upon which petitioner has the burden of proof. Petitioner bears the burden of proof as to both the deficiencies and the section 6654 additions to tax. Rule 142(a)[2]; Welch v. Helvering, 290 U.S. 111 (1933). Therefore, as to these issues, we sustain respondent's determinations.

In his amended answer to the petition, respondent made the following affirmative allegations regarding the section 6653(b) addition to tax for fraud:

> FURTHER ANSWERING the petition, respondent alleges in support of the assertion of the fraud penalty under section 6653(b) for taxable years 1981 and 1982 that:
>
> a. At the time of the due date for filing of each tax return for taxable years 1981 and 1982, petitioner was intelligent and of sound mind.

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[2] Unless otherwise indicated, all rule references are to the Tax Court Rules of Practice and Procedure.

b. At the time of the due date for filing of each tax return, petitioner had experience with filing income tax returns.

c. At the time of the due date for filing of each tax return, petitioner had obtained sufficient experience and a level of education to understand the obligation to pay Federal income taxes.

d. During 1981 and 1982, petitioner earned $29,519.45 and $22,216.65 in the amounts and from the employers designated in Schedule 1(a) of the notice of deficiency. See Exhibit A.

e. Petitioner also received unemployment compensation from the Virginia Employment Commission in the amounts of $1,041 and $966 for 1981 and 1982, respectively.

f. Petitioner received $31.99 in interest in 1981 from Madison National Bank, Plumbers and Steamfitters Union, and Pipefitters Annuity Fund.

g. Petitioner refused to cooperate with the Service during examination of his return by refusing to produce books and records. Petitioner filed false forms W-4 for each of the years at issue. In 1982, petitioner filed a bogus claim for refund with the intent to evade taxes known to be due.

h. For each of the years at issue, petitioner intended to defeat or evade the payment of income taxes by failing to file income tax returns or to pay the taxes due for each of the years at issue.

i. For each respective year, all or part of the underpayment of tax is due to fraud.

Petitioner failed to reply to the affirmative allegations and respondent thereupon moved for entry of an order that they be deemed admitted pursuant to Rule 37(c). Because no reply was received as required by Rule 37(a) and (b), we issued an order dated May 17, 1985 granting respondent's Rule 37 motion. We further ordered that the affirmative allegations of fact set forth in paragraphs 27(a) through 27(i) of respondent's amended answer be deemed admitted for purposes of this case.

OPINION

We must first consider whether petitioner is liable for the section 6653(b) additions to tax for fraud. Respondent has the burden of proving by clear and convincing evidence that an underpayment exists, and that part of the underpayment for each year was due to fraud. Section 7454(a); Rule 142(b). This burden is met if it is shown that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968). The affirmative allegations of fact set forth in respondent's amended answer are sufficient to establish that petitioner earned wages and failed to report them as income or to pay the taxes due on them. The existence of an underpayment for each year is therefore clearly established. What remains for decision is whether any part of the underpayment for each year was due to fraud.

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud will never be presumed. Beaver v. Commissioner, 55 T.C. 85, 92 (1970). Fraud may, however, be proven by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otsuki v. Commissioner, 53 T.C. 96, 105-106 (1969).

This Court has previously held that the burden placed upon the Commissioner to establish a taxpayer's fraud can be satisfied through those facts deemed admitted and conclusively established pursuant to Rule 37(c). In Doncaster v. Commissioner, 77 T.C. 334 (1981),[3] we said:

> It is clear from the foregoing that a petitioner cannot, by total and continued silence, ensure that he will not be considered as having, in effect, conceded his case. The fact that * * * [these allegations] are worded in conclusory language does not require a different conclusion. They were "specified allegations" within the meaning of Rule 37(c); in our judgment, their deemed admission more than satisfies the respondent's burden of proof. * * * We are reinforced in our conclusion by the numerous holdings that fraud is a question of fact--albeit an ultimate question of fact. * * * [Doncaster v. Commissioner, supra at 337. Citations omitted.][4]

Here the material factual allegations in respondent's amended answer have been admitted and conclusively establish the following:

(1) Petitioner knew and understood his obligation to pay Federal income taxes.

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[3] See Corbitt v. Commissioner, T.C. Memo. 1984-586; Miller v. Commissioner, T.C. Memo. 1983-476; Hindman v. Commissioner, T.C. Memo. 1983-389.

[4] We note that respondent has the burden of proving the facts necessary to establish an underpayment and may not rely upon petitioner's failure to produce evidence in order to carry his burden. Doncaster v. Commissioner, 77 T.C. 334, 337-338 (1981).

(2) During the two years in issue, petitioner earned $29,519.45 and $22,216.65, respectively, and also received unemployment compensation of $1,041 and $966 for 1981 and 1982, respectively.

(3) Petitioner refused to cooperate with respondent during the examination of his return by refusing to produce his books and records.

(4) Petitioner filed a false W-4 form for each of the years in issue.

(5) Petitioner failed to file Federal income tax returns or pay the taxes due for each of the years in issue.

As a consequence of filing false withholding statements, petitioner rendered the withholding mechanism inoperative. Combined with his failure to file tax returns, petitioner effectively evaded payment of the income tax he owed for the years in issue. While failure to file a return is not by itself conclusive evidence of fraud, it is a factor worthy of consideration, especially when coupled with the submission of false W-4 Forms. Rowlee v. Commissioner, 80 T.C. 1111, 1124-1125 (1983); Habersham-Bey v. Commissioner, 78 T.C. 304 (1982). In addition, by failing to cooperate with respondent in producing his books and records, petitioner forced respondent's agents to determine the sources and amounts of his income. Hebrank v. Commissioner, 81 T.C. 640, 642-43 (1983), affd. per order (11th Cir., Mar. 26, 1985).

In our judgment, the facts set forth above clearly and convincingly establish petitioner's fraud with intent to evade tax. Therefore, we hold that respondent has carried his burden of proof with regard to the section 6653(b) additions to tax.[5]

Finally, we must decide whether damages should be awarded under section 6673. Section 6673, as amended, and as applicable to this case, provides as follows:

> Whenever it appears to the Tax Court that proceedings before it have been instituted or maintained by the taxpayer primarily for delay or that the taxpayer's position in such proceedings is frivolous or groundless, damages in an amount not in excess of $5,000 shall be awarded to the United States by the Tax Court in its decision. Damages so awarded shall be assessed at the same time as the deficiency and shall be paid upon notice and demand from the Secretary and shall be collected as a part of the tax.

When this Court, in its discretion, determines that a proceeding has been instituted or maintained primarily for delay or that a taxpayer's position in a proceeding before this Court is frivolous or groundless, damages up to $5,000 can be awarded to the United States.

We conclude on the record in this case that petitioner's position in this proceeding is both frivolous and groundless and that this proceeding was instituted by him primarily for delay. Petitioner's refusal to pay the filing fee resulted in our sustaining respondent's determinations on the issues with respect to which petitioner has the burden of proof. Petitioner failed to appear at the trial and has never addressed the substantive issues in this case which relate to the correct determination of his income and deductions for the years in issue. Instead, petitioner has asserted that he is not a "person" for purposes of the Internal Revenue Code and that his labor constitutes "property." Such naked assertions involve frivolous, discredited and meritless issues that have resulted in a needless delay in this proceeding, and the unwarranted waste of valuable governmental and judicial resources. Cf. Abrams v. Commissioner, 82 T.C. 403 (1984); McCoy v. Commissioner, 76 T.C. 1027 (1981), affd. 696 F.2d 1234 (9th Cir. 1983); Wilkinson v. Commissioner, 71 T.C. 633 (1979).

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[5] See Marshall v. Commissioner, 85 T.C. 267 (1985) (respondent's burden of proof sustained through facts deemed admitted pursuant to Rule 90(c)).

Petitioner of course had every right to contest respondent's allegations with regard to the section 6653(b) additions to tax for fraud, and exercising or failing to exercise this right cannot be a basis, either alone or in conjunction with other facts, for imposing damages pursuant to section 6673. But petitioner's frivolous allegations in his petition, coupled with his obvious indifference to the prosecution of his case, are evidence that this proceeding was instituted primarily to delay the payment of his taxes. He was advised by respondent that an award for damages would be requested and he was provided with cases clearly demonstrating the frivolous nature of his position. Furthermore, we note that petitioner has been before this Court on a prior occasion where we saw fit to award damages to the

United States under section 6673. In these circumstances, we think damages in the amount of $5,000 are appropriate and, therefore, damages in that amount will be awarded to the United States under section 6673.

An appropriate order
and decision will be entered.

COMPLETED Jul 11. 7/2: 1986-273

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T. C. Memo. 1986-273

UNITED STATES TAX COURT

JAY H. BRAMSON, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10895-84. Filed July 3, 1986.

Robert D. Wilson and Harold Wilson, for the petitioner.

Grant A. Wolfe, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILLIAMS, Judge: The Commissioner determined a deficiency in petitioner's Federal income tax for the taxable year ended December 31, 1980 in the amount of $10,696.12 and an addition to tax pursuant to section 6653(a)[1] in the amount of $534.81. This Court must decide (1) whether petitioner conveyed eight parcels of real property to Zion Memorial Park Association on December 8, 1980 as a charitable contribution within the meaning of section 170(c)(5), and, if so, the fair market value of the contribution; (2) whether petitioner made miscellaneous charitable contributions of $700 of personal property in 1980; and (3) whether any part of the deficiency for 1980 is attributable to petitioner's negligent or intentional disregard of applicable rules and regulations.

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[1] All section references are to the Internal Revenue Code of 1954, as amended and in effect during the year in issue.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. Petitioner, Jay H. Bramson, resided in Lyndhurst, Ohio when his petition was filed.

In 1980 Zion Memorial Park Association ("Zion") operated as a cemetery association. Zion obtained recognition as a tax exempt cemetery association within the meaning of the predecessor section of 501(c)(13) on August 12, 1953. At all times from August 12, 1953 through 1980, Zion was recognized as a tax exempt organization by respondent and was listed in the published list of tax exempt organizations (Internal Revenue Service Publication No. 78). Respondent has not revoked or proposed the revocation of his recognition of Zion's exempt status for 1980.

Petitioner has been employed by Zion since 1954 and has been its president and chief operating officer since 1956. Since August 21, 1953 the majority of the members of the Board of Trustees of Zion have been family members or relatives of the petitioner. Petitioner also has been a member of Zion's Board of Trustees since 1956. As president and chief operating officer of Zion and as a member of the Board of Trustees, petitioner's duties included presiding at all meetings of Zion's members and trustees, signing the records of the meetings, directing the affairs and operations of Zion, and performing such further duties as the trustees may have required from time to time. In addition, petitioner signed all deeds or certificates of ownership; served as the agent upon whom process, tax notices and demands against Zion were served; negotiated contracts; supervised purchases, hiring, and the layout of new sections of roadways on the cemetery premises; filled in for absent employees; attended interments; interacted with undertakers; supervised the erection of monuments, and supervised office functions.

In 1980 Evergreen Memorial Park Association ("Evergreen") operated as a cemetery association. Evergreen obtained recognition as a tax exempt cemetery organization within the meaning of the predecessor section of section 501(c)(13) on August 6, 1953. At all times from August 6, 1953 through 1980 Evergreen was recognized as a tax exempt organization by respondent and was listed in the published list of tax-exempt organizations (Internal Revenue Service Publication No. 78). On July 11, 1983, respondent revoked his recognition of Evergreen's tax exempt status effective January 1, 1978 on the ground that part of Evergreen's net earnings inured to petitioner's benefit in the taxable years 1978, 1979 and 1980 in the form of excessive salaries and non-interest bearing unsecured loans.

Petitioner has been employed with Evergreen since 1954 and has been its chief operating officer since 1957. Since August 6, 1953 the majority of the members of the Board of Trustees of Evergreen have been family members or relatives of petitioner. Petitioner has also been a member of the Board of Trustees of Evergreen since 1957. As chief operating officer and a member of the Board of Trustees, petitioner performed much the same functions for Evergreen as he performed for Zion.

Petitioner has been employed by Hawkins Trading Company ("Hawkins") since 1954. Since 1958 he has served as Hawkins' president and chief executive officer. Hawkins' business from 1959 to the present has consisted primarily of the sale and maintenance of real property. In 1980 petitioner owned 50 percent of the authorized and issued common stock of Hawkins.

In 1980 Zion, Evergreen and Hawkins shared a secretary/bookkeeper and an office located at 2103 St. Clair Avenue, Cleveland, Ohio, an arrangement that had existed since approximately 1956. Hawkins owned the building in which the office was located and paid for its maintenance. In 1980 Zion paid Hawkins $1,200.00 in rent for the use of the office.

Celeste Wells served as secretary and bookkeeper for Evergreen for approximately 20 years and for Zion for approximately 18 years until her retirement in September 1985.

She also worked for Hawkins but after 1970 the volume of work was negligible, and she stopped drawing a salary from Hawkins. After 1970 Wells drew one-third of her salary from Zion and two thirds from Evergreen because Evergreen generated a significantly larger volume of work.

While Wells worked at the office at 2103 St. Clair Avenue, she lived in Cleveland. She would not have worked for Zion if the office had been on the cemetery premises.

In 1980 Zion maintained two offices, a very small one at the cemetery and the other at 2103 St. Clair Avenue in Cleveland. Zion stored one set of cemetery plats at the office on the cemetery grounds, and the wife of one of the employees answered the telephone. Zion maintained the downtown office because it was easier to find a secretary/bookkeeper to work there and because it was necessary to store a second set of cemetery plats there.

Instead of paying petitioner a salary from 1954-1968, Zion used the funds to expand the cemetery. Subsequently, petitioner began to draw a salary of $4,000.00 per year from Zion. At the suggestion of an accountant, in the early 1970's petitioner's salary was terminated, and instead Zion paid a management fee to Evergreen which paid petitioner a salary for his work at both cemeteries. Forty percent of the salary petitioner received from Evergreen represented compensation for services rendered for Zion and 60 percent represented compensation for services rendered on behalf of Evergreen, corresponding to the approximate percentage of time that petitioner devoted to each cemetery. In 1980 Zion paid Evergreen a management fee of $39,000.00. Although Zion is a small cemetery, the scope of its operations is not insignificant. At the close of 1980 Zion had net assets, including land, stocks, bonds, an endowed care trust fund and bank accounts in excess of $1,000,000.00. Zion's total income for 1980 was approximately $115,000.00 and its total expenses, including the management fee to Evergreen, were approximately $112,000.00. Given the scope of Zion's operations in 1980, $39,000.00 is a reasonable expense for management of operations and assets.

Zion has charge accounts only with its major suppliers. Incidental expenses such as pick shovels, small amounts of sod, grass seed, fertilizer, hardware and supplies for the residences of the employees were paid for by petitioner who was reimbursed by Zion for the exact amount of the expenses at the end of the month. Wells, the bookkeeper, never reimbursed anyone without a bill or receipt. When petitioner charged items for Zion on his personal credit cards, Wells would write a check on Zion's account to the credit card company for the amount of the bills petitioner presented and would pay the remainder of the credit card bill from petitioner's personal account.

In 1980, petitioner incurred expenses on behalf of Zion for miscellaneous supplies. In addition, petitioner occasionally took funeral directors to lunch and his employees to dinner if they had to work late. When a member of the funeral director's family passed away, petitioner also purchased a wreath for $35 or $40.

Unlike Zion, Hawkins Trading Company had extensive credit. On one occasion, Hawkins advanced credit to Zion for carpeting at Zion Memorial Park. Hawkins ordered the carpeting because it had established credit with the carpet company and was entitled to a discount. Zion directly paid the bill for the carpeting and thereby received the benefit of Hawkins' discount.

Zion also made four other payments on Hawkins' account in 1980:

Date	Payee	Amount	Explanation
8/20/80	The Higbee Co.	$ 24.13	Office expense
9/05/80	I.B.M. Co.	108.29	Office expense
10/14/80	Sunmark Industries	393.32	Gasoline
12/29/80	The Higbee Co.	36.41	Office expense

We find these amounts to be Zion's expenses.

Petitioner is a real estate investor and has purchased and sold real estate for himself and members of his family. Between 1976 and 1980 petitioner donated unimproved property to several charitable organizations and governmental entities. During the period 1963 through 1980, petitioner and members of his family donated numerous parcels of real property to Zion.

On December 8, 1980, petitioner donated eight parcels of unimproved property located in Cuyahoga County, Ohio to Zion and claimed a deduction of $27,500 for the donation as a charitable contribution. Respondent determined that petitioner had significantly overstated the value of the properties. The chart below sets forth the fair market values of the donated properties as claimed by petitioner and as determined by respondent:

Cuyahoga County Ohio Permanent Parcel Number	FMV Claimed by Petitioner	FMV Determined by Respondent
A. 108-28-005	$ 4,000.00	$1,000.00
B. 142-27-212	5,000.00	2,600.00
C. 361-17-029	7,000.00	1,850.00
D. 795-07-120,121,122	7,500.00	1,000.00
E. 795-08-046,048	4,000.00	0.00
Total	$27,500.00	$6,450.00

In 1980 Permanent Parcel Number 108-28-005 ("Property A") was a 30' x 90' unimproved parcel with access to public utilities. Property A was zoned commercial, a designation that permits both commercial and residential uses, and was located on the westerly side of East 108th Street, South of St. Clair Avenue, in the northeast section of Cleveland, Ohio. The surrounding neighborhood on December 8, 1980, was an area of both residential and commercial uses. The neighborhood was fully developed and in a state of declining growth. Property A had no viable commercial use. Due to the dimensions of Property A, the proximity of adjacent buildings, and the proximity restraints imposed on residential use property under the Cleveland zoning laws, the types of residential improvements that could be built on Property A were significantly restricted. We find the fair market value of Property A to be $1,000 on December 8, 1980.

In 1980 Permanent Parcel Number 142-17-212 ("Property B") was a 30' x 15' unimproved parcel with access to public utilities. Property B is zoned for residential use and located on the south side of Ohio Avenue, on the south side of Cleveland, Ohio. In 1980 the immediate area was residential but large tracts of property adjacent to Property B were zoned and developed for industrial use. We find the fair market value of Property B to be $2,600 on December 8, 1980.

In 1980 Permanent Parcel Number 361-17-029 ("Property C"), an approximately 60' x 66' unimproved parcel with access to public utilities, was zoned single family residential and was located on the westerly side of Wesley Drive in the City of Berea, Ohio. All of the surrounding properties had been developed for residential use. We find the fair market value of Property C to be $1,850 on December 8, 1980.

In 1980 Permanent Parcel Numbers 795-07-120, 121 and 122 ("Property D") and Permanent Parcel Numbers 795-08-046 and 048 ("Property E") were unimproved parcels located in the northern part of Oakwood Village, Ohio. The village had not installed any public improvements to serve Property D or Property E. All of the subject parcels were in an area zoned residential. The immediate area was only partially developed with a mixture of older and newer residential construction.

Property D comprises three adjacent parcels identical in size. Property D is rectangular with dimensions of 120' x 150' located on the west side of Northam Drive between Booker Avenue and Suwanee Avenue, an undeveloped area. We find the fair market value of Property D to be $1,000 on December 8, 1980.

Property E consists of two parcels of unimproved land, each measuring 40' x 125'. The parcels are not contiguous. Property E is located on the northerly side of Suwanne Avenue west of Lawson Road and east of Kentucky Drive, and as of January 1986, Suwanee Avenue at the sight of the subject properties had not been developed. We find Property E to have had a nominal $10 value on December 8, 1980.

Petitioner claims to have made several other noncash charitable contributions in 1980 for which he claimed deductions totaling $700.00. Included in this amount were several miscellaneous items donated to the Salvation Army, the fair market value of which was claimed to be $150.00. The receipt for these items was made out to "Mrs. Simon" at "24728 Letchworth, Beachwood ________________ 44122." Mrs. Simon was petitioner's mother-in-law, and the zip code 44122 is a location in Ohio. We find that petitioner's mother-in-law donated the personal property and not on petitioner's behalf. Another donation that petitioner claims that his mother-in-law made on his behalf was a recliner and two chairs to the Volunteers of America which he valued at $150.00. The date on the receipt for this donation is April 19, 1978. We find that petitioner did not make the claimed donation to Volunteers of America and that the donation was made in 1978. Petitioner also claimed a deduction for a foosball[2] table donated to the City of Ithaca, New York. Petitioner purchased the table for $895.00 and claimed it had a value of $400.00 when donated. The receipt for the donation is dated May 23, 1980.

OPINION

The first issue for decision is whether petitioner's conveyance of eight parcels of real estate to Zion in 1980 constituted a contribution or gift to or for the use of a cemetery company within the meaning of section 170(c)(5). Respondent contends that Zion was not in 1980 a cemetery company within the meaning of section 170(c)(5) because petitioner used Zion for his personal enrichment.

The statute prohibits inurement to a private shareholder or individual. Petitioner's contribution to Zion will not be deductible if any part of Zion's net earnings inured to petitioner for his private benefit. Payment of an unreasonable or excessive salary to an officer of a nonprofit corporation constitutes inurement, Knollwood Memorial Gardens v. Commissioner, 46 T.C. 764, 787 (1966), as does payment of unreasonable rents, Texas Trade School v. Commissioner, 30 T.C. 642, 647 (1958), affd. per curiam 272 F.2d 168 (5th Cir. 1959), and the payment of personal expenses of an officer of the exempt organization. Restland Memorial Park of Dallas v. United States, 509 F.2d 187, 189 (5th Cir. 1975).[3] An important criterion for determining whether payments are unreasonable is whether the exempt organization could obtain the same services more cheaply from an outside source. Cf. B.H.W. Anesthesia Foundation, Inc. v. Commissioner, 72 T.C. 681, 686 (1979).

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[2] Foosball is a game played on a table designed to resemble a soccer field. There are handles on the sides with which the players push the ball up and down the field.

Respondent contends that certain payments that Zion made in 1980 resulted in inurement of net earnings to petitioner for his private benefit. The payments at issue are Zion's payment of a management fee to Evergreen for services petitioner rendered to Zion; Zion's payment of a portion of petitioner's credit card bills and of certain expenses billed directly to Hawkins; and Zion's payment of rent to Hawkins.

We believe that petitioner has carried his burden of proof to explain each of these payments. In so holding, we have relied heavily on the testimony of Celeste Wells, the retired bookkeeper of Zion. Her testimony was straightforward, confident and unblemished by respondent's cross-examination.

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[3] Although all of these cases concern eligibility for tax exempt status under section 501(c), the language prohibiting inurement is identical to that in section 170(c)(5).

The management fee paid to Evergreen represented compensation for services actually rendered to Zion and on this record the amount appears to be reasonable.[4]

Zion's payment of a portion of petitioner's credit card bills did not constitute inurement but reimbursement for expenses he incurred on behalf of Zion. Similarly Zion's payment of a bill on Hawkins' account in 1980 was for the purchase of carpeting used by Zion.[5] Zion paid $1,200.00 in rent in 1980 for the office that it shared with Evergreen and Hawkins. On this record that amount appears to be reasonable. Petitioner is, therefore, entitled to a deduction under section 170(c)(5) for his contributions of real property to Zion in 1980. Consequently, we must determine the fair market value of the properties contributed.

Fair market value is the price at which property would change hands between a willing seller and a willing buyer, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. See section

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[4] On July 11, 1983, the Internal Revenue Service revoked Evergreen's tax exemption effective January 1, 1978, in part because some of Evergreen's net earnings inured to petitioner's benefit in the form of excessive salaries. Evergreen's status was not at issue before the Court, and we do not comment on it. The revocation of Evergreen's tax exemption in 1983, however, is not dispositive of whether Zion paid Evergreen an excessive management fee in 1980.

[5] Based on Wells' testimony, Zion's payment of office expenses and a repair bill charged on a gasoline card was payment of its own expenses.

1.170A-1(c)(2), Income Tax Regs. We hold that petitioner has not carried his burden of proof. Welch v. Helvering, 290 U.S. 111, 112 (1933).

To estimate the value of unimproved properties, appraisers most frequently rely on the comparable sales method of valuation. The comparable sales approach produces an estimation of value by comparing the subject property to similar properties that recently have been sold in the vicinity. The reliability of the comparable sales method depends on several factors, including the availability of verifiable comparable sales data and the degree of comparability of the properties.

Wayne Levering, a professional appraiser, valued the subject properties for petitioner as of December 8, 1980. As to each parcel of property, we find that Levering's practices were cursory, unreliable, and inaccurate. Levering used properties that were not in fact comparable to value the subject properties and as a result significantly overstated their values. He relied on sales of commercially zoned properties as comparable sales data to value property zoned for residential use and sales of residentially zoned properties to value property zoned for commercial use. He used sales of properties in a generally well-maintained neighborhood to value a parcel in a declining neighborhood. Moreover, he listed some supposedly comparable properties as unimproved which in fact had been improved as of the comparable valuation date and significantly overstated the size of Property C because he had not examined the deed.

Respondent's appraiser, Gregory Zivoder, provided forthright and reliable evaluations of fair market value for the subject parcels, and we accept his findings. Specifically with regard to our finding that Property E had only minimal value as of December 8, 1980, it appears that the only verified sales of unimproved property in the immediate area between 1972 and 1982 were condemnation or sheriff's sales for taxes owed. Although a sheriff's sale is a distress sale and is, generally, not a reliable indicator of fair market value, in the case of Property E, the sheriff's sales are the only sales of comparable properties in the area. Zivoder relied on sheriff's sales of improved properties as comparable sales and because Property E was unimproved, subtracted the cost of improvements from the average sale price of the comparable properties. The cost of improvements exceeded the price anyone was willing to pay in 1980 for the right to carry the taxes on the comparable properties. Thus, Zivoder appraised Property E as having no fair market value as of the valuation date. Since we are not persuaded that the full cost of improvements should be subtracted from the sheriff's sale price to determine Property E's fair market value, we find that Property E had some value which we find to be $10.

The second issue is whether petitioner has substantiated $700.00 in miscellaneous contributions for which he claimed deductions on his 1980 joint Federal income tax return. Harris v. Commissioner, 745 F.2d 378, 379 (6th Cir. 1984). We find that he has not.

Petitioner claimed deductions in 1980 for (1) miscellaneous items that were donated to the Salvation Army and valued at $150.00; (2) a recliner and two chairs that were donated to the Volunteers of America and valued at $150.00; and (3) a foosball table that petitioner donated to the City of Ithaca and valued at $400.00. The receipts that petitioner submitted to substantiate his donations to the Salvation Army and the Volunteers of America, however, were issued to petitioner's mother-in-law. The date on the Volunteers of America receipt is September 19, 1978. Petitioner did not specifically testify as to the date he donated the foosball table to the City of Ithaca, and the receipt does not state when the foosball table was received.[6] We therefore hold that petitioner has not sustained his burden of proof that he made any of these contributions in 1980.

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[6] In response to the question whether he had made any donations of personal property in 1980, petitioner stated generally that he had made donations to the Salvation Army, the Volunteers of America and the City of Ithaca. Given that the receipt from the Salvation Army offered to help substantiate petitioner's contribution was his mother-in-law's and that the receipt offered to help substantiate petitioner's donation to the Volunteers of America bears the date September 19, 1978 (and is also in his mother-in-law's name), we are not inclined to believe that petitioner donated the foosball table in 1980 without more specific evidence of when the donation was made and when the City of Ithaca actually received it.

Finally, we decide that petitioner is liable for the addition to tax under section 6653(a) for negligence or intentional disregard of rules and regulations. Respondent's determination of negligence or intentional disregard of rules and regulations is prima facie correct and petitioner bears the burden of proof to the contrary. Bixby v. Commissioner, 58 T.C. 757 (1972). Petitioner has not shown that he acted reasonably and prudently and exercised due care in obtaining appraisals of fair market value for the property he donated to Zion and in claiming deductions for donations to other organizations in 1980. See Neely v. Commissioner, 85 T.C. 934, 947-48 (1985).

To determine the value of the real property he donated to Zion in 1980, petitioner relied on an appraisal report prepared by Wayne Levering. Levering had done appraisals of petitioner's donated properties in previous years and, on at least one occasion, had shown his work to be unreliable.[7] We believe that petitioner should have inquired into the comparable properties that Levering selected for the appraisals. Had he done so, petitioner would have seen that the values were significantly overstated. Moreover, as an experienced real estate investor in the Cleveland area, petitioner can be expected to have a better than average knowledge of land values in the area. Petitioner is a sophisticated business man who, we believe, knew that he was overstating the value of his claimed deductions. Finally, as to the miscellaneous personal deductions, we believe petitioner knew, for the donations to the Volunteers of America and to the Salvation Army, that he had not made them. Petitioner was negligent in claiming the amount of the deduction for charitable contributions on his 1980 return.

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[7] On October 20, 1980, Levering completed a certificate of appraisal for petitioner valuing Permanent Parcel Number 019-14-117 at $10,000.00 as of December 31, 1977. He used several nearby properties as comparable sales. Levering did not physically inspect the parcel or examine the deed. Had he done so, he would have discovered that the City of Cleveland had acquired the property from petitioner in 1964 by eminent domain and that as of the valuation date it was part of an interstate highway.

To reflect the foregoing,

Decision will be
entered under Rule 155.

JUL 11.7/2:1986-27

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ORIGINAL

T. C. Memo. 1986-274

UNITED STATES TAX COURT

ROGER H. SMITH AND JANE A. SMITH, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 26959-84. Filed July 3, 1986.

Jane A. Smith, pro se.

Gail K. Gibson, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

GERBER, Judge: Respondent, by a statutory notice of deficiency dated April 25, 1984, determined a $2,278 deficiency in petitioners' 1981 Federal income tax. Petitioners resided in Minnetonka, Minnesota, at the time of filing their petition in this case. The parties have resolved all adjustments set forth in the statutory notice, with the exception of a $7,272 item.

The issue presented is whether the amount petitioner[1] received from the University of Minnesota is includable in income or is a scholarship or fellowship grant within the meaning of section 117(a).[2]

Petitioner, along with her husband, Roger H. Smith (who was employed primarily as a minister by the Unitarian Universalist Church of Minnetonka), filed a joint Federal income tax return for 1981 reflecting, among other items, $7,272 as payment from the University of Minnesota (University) during the time that petitioner was enrolled in a Master of Science program (Program) at the University, but excluding the same from income as a scholarship or fellowship grant.

Petitioner received her undergraduate B.S. in Zoology from the University of Texas in 1959. During the next 20 years, petitioner worked at various times and locations as a researcher with emphasis on the study of cells and cell development. Early in 1979, petitioners moved from Berkeley, California, to Minnesota to enable petitioner to study with Dr. C. E. Green, a professor at the University, because of his expertise in petitioner's specialized area of cellular research. Petitioner had been working on a theory she had conceived concerning cell development. She wished to continue her work on the theory at the University.[3]

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[1] "Petitioner," when used in the singular, refers to Jane A. Smith.

[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended for the taxable year in issue. All rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner sought to enroll in the Program at the University to serve two major purposes: (1) Complete work on her theory as part of her Master's thesis and (2) attain a Master of Science degree in Plant Physiology. When she arrived in early 1979, however, it became apparent that the Program was not available to her. Accordingly, from March 1979 to September 1980, she enrolled in non-degree courses with Dr. Green, at the same time working as a research employee at the University. During this time, petitioner worked on her own theory when her schedule permitted, and negotiated with the University to obtain graduate status.[4]

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[3] Petitioner pointed out that the University was one of the few that had appropriate laboratory equipment and cell culture development to facilitate her research.

[4] The University handbook describes general policies and procedures concerning graduate assistantships, and directs that specific inquiries concerning assistantships be made to the individual departments. According to the handbook, the intended role of the "graduate assistants," fulfills a dual function: to provide "the University with * * * instructional and research staff * * *" and to provide graduate students professional experience. The handbook distinguishes between graduate assistants whose "tasks * * * are part of [their] degree requirements" and those "employed and paid to handle specific assignments in addition to those required by the degree." (Emphasis added.)

Furthermore, the handbook distinguishes between various kinds of graduate assistantships, including research assistants and teaching assistants and associates. Research assistants are designated as either project assistants or research assistants.

(footnote continued)

After being denied entrance to the Program because of the lack of available University funding, petitioner approached Dr. Green with her problem. In the spring of 1980, Dr. Green arranged with two other professors to transfer amounts from other research to allow petitioner to work on her theory, as follows:

C. E. Green	$3,636
B. G. Gengenbach	1,818
I. Rubenstein	1,818
	$7,272[5]

Besides being funded separately, the terms of petitioner's graduate assistantship varied from the general program in that she was not required to do any teaching or research on University projects and, in fact, did neither.

During the first part of her program, petitioner spent the majority of her time studying because she had been away from scholastic situations for about 20 years and she found study and classroom preparation to be difficult. Petitioner then was permitted to work solely upon the subject of her thesis, which consisted of the proof of her own theory, which was not an

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(footnote continued from previous page)
Project assistants research in non-thesis related areas; research assistants in thesis related areas. The handbook also includes the statement that graduate students may not hold appointments for which there is no monetary compensation.

[5] These transfers were utilized to admit petitioner to the program with Dr. Green as her advisor. By the time the University had agreed to afford petitioner graduate status, there were no official funds set aside by the Department of Agronomy for graduate students.

established University research project. Petitioner wrote her thesis during the summer and fall of 1981 and completed her course work during the winter of 1982, thus fulfilling the Program's degree requirements. The University published her thesis, and Dr. Green was listed as a coauthor. Petitioner received a Master of Science degree on March 20, 1982.

The University's treatment of petitioner changed after petitioner began the Program. The University generally did not treat petitioner as an employee, although the payments received were issued from the Payroll Division of University Personnel and a W-2 was issued to petitioner. The University stopped paying the medical plan, and other employee benefits petitioner had received when she performed research work for the University prior to entering the Program.

Petitioner contends that the payments from the University are scholarship or fellowship grants within the meaning of section 117(a) and not includable in income. Respondent argues that the payments are taxable as income because they were in exchange for services rendered.

OPINION

Section 117(a) excludes from gross income amounts received by an individual as a scholarship or fellowship grant.[6]

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[6] Sec. 117(a) states:

> (a) General Rule.--In the case of an individual,

(footnote continued)

Scholarships and fellowship grants are defined as amounts paid to an individual to aid in the pursuit of study or research. Section 1.117-3(a), (c), Income Tax Regs. Amounts which represent either "compensation for past, present, or future employment services" or which represent "payment for services which are subject to the direction or supervision of the grantor" are not considered to be scholarships or fellowship grants. Sec. 1.117-4(c)(1), Income Tax Regs. However,

> [n]either the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor shall, of

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(footnote continued from previous page)

> gross income does not include--
>
> (1) any amount received--
>
> (A) as a scholarship at any educational organization described in section 170(b)(1)(A)(ii),
>
> or
>
> (B) as a fellowship grant,
>
> including the value of contributed services and accommodations; and
>
> (2) any amount received to cover expenses for--
>
> (A) travel,
>
> (B) research,
>
> (C) clerical help, or
>
> (D) equipment,
>
> which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

> itself, be considered to destroy the essential character of such amount as a scholarship or fellowship grant.

Section 1.117-4(c)(1), Income Tax Regs. In Bingler v. Johnson, 394 U.S. 741, 751 (1969), the Supreme Court sustained the validity of these regulations, as comporting with the ordinary understanding of scholarships and fellowships as "relatively disinterested, 'no strings' educational grants, with no requirement of any substantial quid pro quo from the recipients."

Section 117(b)(1) limits section 117(a) (the general exclusion) in cases of individuals who are candidates for degrees.[7] But this limitation, and the exception contained therein, are applicable only if the payment in question first has been found to constitute a scholarship or fellowship grant. Reese v. Commissioner, 45 T.C. 407, 413 (1966), affd. per curiam 373 F.2d 742 (4th Cir. 1967).

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[7] Sec. 117(b), in pertinent part, states:

> (b) Limitations.--
>
> (1) Individuals who are candidates for degrees.-- In the case of an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii), subsection (a) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving such degree, such teaching, research, or other services shall not be regarded as part-time employment within the meaning of this paragraph.

The test to determine whether a payment is a scholarship or fellowship grant is whether the primary purpose underlying the payment is to educate the recipient or whether it is to compensate him for services rendered, and this determination is a question of fact. Section 1.117-4, Income Tax Regs.; Yarlott v. Commissioner, 78 T.C. 585, 595 (1982), affd. 717 F.2d 439 (8th Cir. 1983). In making this determination, the focus is on the primary purpose of the grantor in making the payment. See Fisher v. Commissioner, 56 T.C. 1201, 1214 (1971). Petitioner bears the burden of proof that the amounts received were scholarships or fellowship grants. Olick v. Commissioner, 73 T.C. 479, 486 (1979); Rule 142(a).

Accordingly, we first consider whether the monies paid to petitioner were intended primarily as payment in return for her services or whether they were intended to furnish her with an opportunity to further her education for her own benefit. We conclude that the monies paid to petitioner were paid primarily for the purpose of allowing petitioner to further her education through developing her theory.

We rest our conclusion on several factors. First, petitioner worked solely on her studies or her theory during the time in question. The University did not receive a direct substantial benefit from petitioner's research. Petitioner neither taught at the University nor did research on any

University project. Furthermore, there is no indication that petitioner was required to publish her findings, and in fact petitioner submitted her thesis after her stipend ran out.[8]

Additionally, petitioner's stipend was funded from monies originally designated to be used for University projects. After petitioner was told that all University funds for the year in question had been otherwise allocated, Dr. Green and two other professors each contributed funds from their budgets, so that petitioner could continue her work.[9]

Viewing the record as a whole, we conclude that the primary purpose of the payments in question was to allow petitioner to continue her research.[10]

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[8] Although petitioner's research actually resulted in a University published thesis with Dr. Green designated as a coauthor, we do not find this benefit alone as determinative of the compensatory nature of the payments. See Yarlott v. Commissioner, 78 T.C. 585, 603 (1982), affd. 717 F.2d 439 (8th Cir. 1983).

[9] Respondent argues that the record does not support petitioner's contention concerning the funding of her program. We disagree. We find petitioner to be an intelligent, forthright and candid witness, and her testimony, both generally and on this particular point, to be credible.

[10] The focus of this determination is on the grantor. In determining the identity of the grantor, we look to who selected the recipient and determined her duties. See Fisher v. Commissioner, 56 T.C. 1201 (1971). Arguably, the grantor here could be either the University or the three professors. It seems clear to us, however, that the primary purpose of petitioner's stipend was to allow her to develop her theory, viewed from either the University or the professors' perspectives. Additionally, we note that the original source of the funds actually used is unclear, and that for the school year beginning September 1980, apparently the only reason petitioner initially was denied admittance to the graduate program was due to lack of available University funds.

On brief, respondent cites four cases concerning alleged scholarship or fellowship grants from the University in which we have found such payments to be taxable as income.[11] Respondent maintains that this case is indistinguishable. We disagree. In each of the cited cases, we determined that the University received a quid pro quo in exchange for the payments made to petitioner.[12] We have found no such quid pro quo present here.

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[11] See El Deeb v. Commissioner, T.C. Memo. 1984-205, affd. 766 F.2d 381 (8th Cir. 1985); Joy v. Commissioner, T.C. Memo. 1984-410; Zimmerman v. Commissioner, T.C. Memo. 1984-207; and Tate v. Commissioner, T.C. Memo. 1984-206.

[12] In El Deeb, Tate, and Zimmerman, petitioners were required to perform substantial teaching duties, thus alleviating the need for the University to hire other instructors. In Joy, petitioner was selected in order to satisfy the University's staff needs, and petitioner worked more than 20 hours per week on research used in the completion of a University project.

Furthermore, although the parties did not address this issue directly, we conclude that the limitation specified in section 117(b) is inapplicable, since the research done by petitioner was not in the nature of part-time employment.[13] Section 1.117-2(a), Income Tax Regs.

Accordingly,

Decision will be entered under Rule 155.

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[13] We have already determined that the primary purpose of the stipend was to allow petitioner to develop her theory and not as compensation for services rendered. Even if the research done by petitioner were regarded as part-time employment, we note that respondent does not contest that the thesis research done by petitioner was a requirement of the degree she obtained. Reese v. Commissioner, 45 T.C. 407, 414 (1966), affd. per curiam 373 F.2d 742 (4th Cir. 1967); Chen v. Commissioner, T.C. Memo. 1979-407.

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T. C. Memo. 1986-276

UNITED STATES TAX COURT

STEVEN L. ALBERT and JOYCE E. ALBERT, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 5881-85. Filed July 3, 1986.

Steven L. and Joyce E. Albert, pro se.

Dean H. Wakayama, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COUVILLION, Special Trial Judge: This case was assigned pursuant to the provisions of section 7456(d) of the Code[1] and Rule 180.

Respondent determined deficiencies in petitioners' Federal income tax for the years 1981 and 1982 in the amounts of $1,242 and $1,280, respectively; and an addition to the tax for the year 1982 in the amount of $46.30, under section 6651(a)(1).

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[1] All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise indicated; and all Rule references are to the Tax Court Rules of Practice and Procedure.

The issues for decision are whether petitioners are entitled to deduct transportation expenses incurred by Steven L. Albert (petitioner) in commuting from his residence to his job site during 1981 and 1982, under section 162(a); and whether petitioners are liable for a section 6651(a)(1) addition to tax for failing to file their 1982 tax return by the date required by law.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found which, with the attached exhibits, are incorporated herein by reference. At the time the petition was filed, petitioners were residents of Orting, Washington.

Petitioner was employed as an ironworker by Morrison-Knudsen Company Inc. (Morrison) during 1981 and 1982 on the Washington Power Supply System (WPSS) nuclear power plant construction project at Satsop, Washington. He was a member of a union and obtained his employment with Morrison through his union.

Petitioner traveled some 160 miles back and forth on a daily basis between his residence in Orting, Washington, to the Satsop job site and claimed a deduction for such travel. Respondent, in the notice of deficiency, disallowed $3,413 of the total of $5,475 claimed as such expenses by petitioners on their 1981 return. During trial, however, respondent orally moved to amend the answer to conform to the evidence, thus disallowing the entire $5,475 claimed by petitioners for 1981. Respondent's motion was granted. The notice of deficiency also disallowed petitioners' deduction of $3,413 travel expenses for 1982. Respondent's position is that the expenses for the two years were personal commuting expenses and the job was not temporary so as to qualify for the exception, under section 162(a), to the general prohibition against deducting personal expenses set out in section 262. We agree.

OPINION

Respondent's determinations in the notice of deficiency are presumed correct, and petitioners have the burden of proving otherwise. Welch v. Helvering, 290 U.S. 111 (1933); Rule 142(a). Respondent, however, has the burden of proof with respect to the additional deficiency asserted in the amendment to his answer. Reiff v. Commissioner, 77 T.C. 1169, 1173 (1981); Estate of Emerson v. Commissioner, 67 T.C. 612, 620 (1977).

As a general rule, section 262 disallows expenses for personal, living, or family expenses. Transportation expenses ordinarily incurred between one's residence and one's principal place of business, typically referred to as "commuting expenses," are nondeductible personal expenses under section 262. Fausner v. Commissioner, 413 U.S. 838 (1973); Commissioner v. Flowers, 326 U.S. 465 (1946). However, an exception to this general rule is provided when a taxpayer's employment is "temporary," rather than "indefinite" or permanent in nature. Peurifoy v. Commissioner, 358 U.S. 59, 60 (1958).

This Court has held that employment is temporary if its termination within a short period of time can be foreseen. Mitchell v. Commissioner, supra; Albert v. Commissioner, 13 T.C. 129, 131 (1949). Employment is indefinite if either its termination within a fixed or reasonably short period of time cannot be foreseen, Stricker v. Commissioner, 54 T.C. 355, 361 (1970), affd. 438 F.2d 1216 (6th Cir. 1971), or it continues for a substantial or indefinite duration. Garlock v. Commissioner, 34 T.C. 611, 614-615 (1960).

The Ninth Circuit, to which an appeal in this case would lie, in Neal v. Commissioner, 681 F.2d 1157 (9th Cir. 1982), affg. per curiam a Memorandum Opinion of this Court, adopted Kasun v. United States, 671 F.2d 1059 (7th Cir. 1982), as "the law of [the Ninth] circuit" with respect to the temporary versus indefinite employment issue. In Kasun, the court held "employment which merely lacks permanence is indefinite unless termination is foreseeable within a short period of time." 671 F.2d at 1061. The court further noted that employment may change from temporary to indefinite due to the passage of time. The burden of proving that employment is temporary rests on the taxpayer. Rule 142(a). Determination of whether a job is temporary is a factual question. Peurifoy v. Commissioner, supra.

On the record before us, petitioners have failed to satisfy their burden of proving that petitioner's termination was foreseeable within a short period of time.

Petitioner worked at Satsop for some 27 months, which included the entire year 1981 and up to December 15, 1982. At the time he began to work there, he was advised by his employers that they did not know how long the job would last. Petitioner stated that he was a foreman and "every so often" was told "you will lay off 20 percent of your manpower." Petitioner stated "[t]his happened all during the year." Sometime during 1982, petitioner lost his foremanship because of layoffs, and became one of the "workers." It is clear to this Court that petitioner had some seniority and expected to remain employed for an indefinite period.

Petitioner complains that his lack of permanence made his job temporary. The lack of permanence of the job, however, does not by itself make the job temporary. Kennedy v. Commissioner, 451 F.2d 1023 (3d Cir. 1971), affg. per curiam a Memorandum Opinion of this Court. Petitioners argue that petitioner could have been laid off at any time. Such fact, however, points to the impermanent nature of petitioner's employment and does not prove that his employment was temporary. This fact is not determinative of whether his employment was temporary rather than indefinite. McCallister v. Commissioner, 70 T.C. 505, 510 (1978). The substantial duration of petitioner's employment supports a conclusion that his employment was "indeterminate in fact as it develop[ed]." Norwood v. Commissioner, 66 T.C. 467, 471 (1976). Petitioners cited Frederick v. United States, 603 F.2d 1292 (8th Cir. 1979), in support of their position. That case is factually distinguishable in that the work done by the employee in Frederick was seasonal, and he expected to be laid off when winter came. In this case, petitioner's work was not seasonal, and he did not expect to be laid off as was the situation in Frederick.

Based on the record as a whole, we find that petitioner's employment was indefinite and not temporary.[2] Therefore, expenses incurred in traveling to his employment in Satsop are personal commuting expenses, which are nondeductible under section 262.

Respondent's motion to amend the answer, to increase the disallowed expenses for 1981 from $3,413 to $5,475, increases the determined deficiency against petitioners for that year. Respondent based the motion to amend on an error in the preparation of the notice of deficiency. Respondent bears the burden of proof when an increase in the deficiency is asserted. Rule 142(a). We find that respondent has met that burden by petitioner's admission, on cross-examination, that the additional expenses disallowed were transportation expenses incurred in commuting from his home to the job site.

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[2] This finding follows the holding of this Court in a case by petitioner for the year 1980 in which his commuting expenses to the same job site were disallowed. See Steve L. and Joyce E. Albert v. Commissioner, Docket No. 13524-84S, T.C. Summary Opinion 1985-136. This Court, in reaching its decision for 1980, considered the 1981 and 1982 work schedule of petitioner at the Satsop job site.

As to the section 6651(a)(1) addition to tax, petitioners bear the burden of proof on this issue. Welch v. Helvering, supra; Rule 142(a). Petitioners failed to introduce any evidence or address this issue; therefore, petitioners have failed to carry their burden on this issue.

Decision will be entered under Rule 155.

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T. C. Memo. 1986-277

ORIGINAL

UNITED STATES TAX COURT

EVA E. WICKERT, Petitioner v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 34899-83. Filed July 7, 1986.

David G. Hartmann and William G. Line, for the petitioner.

J. Anthony Hoefer, for the respondent.

MEMORANDUM OPINION

FAY, Judge: This case is before the Court on petitioner's motion for an award of reasonable litigation costs pursuant to Rule 231 and section 7430.[1] The issues for decision are (1) whether petitioner should be awarded reasonable litigation costs pursuant to section 7430, and if so, (2) whether the amount of litigation costs requested by petitioner in her motion is reasonable.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner, Eva E. Wickert, resided in West Point, Nebraska, when she filed her petition herein.

By statutory notice of deficiency dated September 20, 1983, respondent determined deficiencies in petitioner's Federal income tax for 1979 and 1980 in the amounts of $2,162 and $1,700 respectively. Petitioner filed a petition with the Court on December 15, 1983. The instant case was calendared for trial at the Court's trial session at Omaha, Nebraska, beginning on December 17, 1984. At the call of calendar, the parties filed with this Court a stipulation of settlement whereby respondent conceded the only adjustment in the notice of deficiency, concerning the characterization as alimony of amounts received by petitioner, and all the deficiencies he determined arising therefrom with respect to petitioner's Federal income tax liability for 1979 and 1980. Petitioner filed on that same day pursuant to section 7430 a motion for an award of reasonable litigation costs in the amount of $4,240.64. Thereafter, respondent filed a notice of objection to petitioner's motion and petitioner filed a reply to such objection.

The underlying controversy arose from the characterization of payments made by petitioner's former spouse Charles R. Wickert (herein "Mr. Wickert") to petitioner pursuant to a decree of divorce entered on February 24, 1979, by the District Court of Cuming County, Nebraska. Such decree provided for the payment to petitioner of the sum of $103,000 which is described in the decree as representing petitioner's interest in a farm and in the personal property of petitioner and Mr. Wickert. Such payment was to be made in eleven annual installments; the first installment in the sum of $30,000 was due on March 1, 1979, and the remainder payable in equal installments with the last installment due on March 1, 1989. It was stated in the decree that such payment was "to be construed as a property settlement and not as alimony." Nevertheless, for 1979 and 1980, Mr. Wickert deducted the installments paid as alimony pursuant to section 215. Petitioner did not include such amounts as income in her returns for such years. Faced with the inconsistent treatment of the same item, respondent issued notices of deficiency on September 20, 1983 to both petitioner and to Mr. Wickert wherein adjustments were made to disallow the deduction to Mr. Wickert and to include such amount as income with respect to petitioner. Petitioner timely filed a petition with this Court on December 15, 1983. Mr. Wickert failed to file a petition within the time prescribed under section 6213. Respondent filed an answer to the petition in this case on February 15, 1984.

On February 13, 1984, respondent's district counsel referred the instant case to respondent's appeals office in Omaha, Nebraska for consideration of settlement. Respondent's appeals officer responsible for the instant case determined at that time that Mr. Wickert had failed to file a petition with this Court within the time allowed, and decided that the inconsistent treatment of the payments could be resolved in petitioner's favor. On February 23, 1984, eight days after the answer was filed in the instant case, respondent's appeals officer forwarded to petitioner a proposed stipulated decision which reflected that there was no deficiency in petitioner's Federal income tax for the years in issue. The covering letter enclosed with the proposed stipulated decision stated that such document reflected "the agreement we reached during consideration" of the case, but that the settlement had not yet been approved, and that petitioner would be notified upon approval or disapproval of such settlement.

On March 12, 1984, petitioner's counsel informed respondent by letter that he believed petitioner was entitled to an award of litigation costs; thereafter, on March 20, 1984, petitioner's counsel forwarded to respondent's appeals officer the proposed stipulated decision executed by petitioner. On May 4, 1984, respondent's appeals officer indicated in writing to petitioner's counsel that respondent did not believe the government had acted unreasonably and therefore would not agree to an award of attorney's fees. A conference was held on May 9, 1984, wherein respondent's appeals officer advised petitioner that respondent would concede the adjustment in the notice of deficiency. On June 28, 1984, respondent's appeals officer notified petitioner's counsel that since petitioner was requesting an award of litigation costs, the stipulated decision executed by petitioner and sent to respondent in March 1984, was procedurally inappropriate and that respondent's district counsel would prepare an appropriate stipulation in accordance with Rule 231. Thereafter, on July 19, 1984, respondent's appeals officer referred the instant case to respondent's district counsel indicating that the government would concede the alimony issue, and that petitioner intended to pursue the recovery of litigation costs. On that same day, respondent's appeals officer sent a form letter to petitioner's counsel, stating that the instant case had been referred to district counsel for preparation for trial. Such letters were routinely sent by respondent's appeals office for the sole purpose of apprising taxpayers of the status of their cases and did not constitute a representation from respondent's counsel as to the status of the case in the hands of respondent's counsel.

Due to the relative novelty of section 7430 and Rules 230 through 232, respondent's district counsel encountered difficulty in drafting a document in compliance with Rule 231.[2] On November 19, 1984, respondent once again contacted petitioner's counsel and reiterated his intent to concede the case in favor of petitioner.

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[2] Section 7430 was enacted on September 3, 1982, as part of the Tax Equity and Fiscal Responsibility Act of 1982 and applies generally to civil actions or proceedings commenced after February 28, 1983. Section 7430(e) provides that "An order granting or denying an award for reasonable litigation costs *** shall be incorporated as a part of the decision or judgment in the case ***." Rule 231(c) requires that a motion for an award of reasonable litigation costs be accompanied by a stipulation "setting forth the terms of the settlement as to each [issue in the case which has been settled by the parties]." Therefore, a stipulation document required herein must be tailored to allow the incorporation in the decision or judgment of the court of the order granting or denying litigation costs.

On November 21, 1984, respondent's district counsel forwarded a proposed stipulation of settlement to petitioner's counsel. Petitioner's counsel found such proposed stipulation unacceptable, and in turn, sent his own proposed version of a stipulation of settlement to respondent. The parties finally agreed on yet a third form of the stipulation on December 5, 1984. Such stipulation was executed and filed with the Court on December 17, 1984.

On her Federal income tax return for 1979, petitioner claimed the earned income credit pursuant to section 43.[3] Respondent determined that such a claim was improper and arranged for disallowance of the credit prior to the issuance of the notice of deficiency.[4] Respondent then directed that a partial assessment be made.[5] During the period from December 30, 1983 to August 24, 1984, petitioner received three collection letters from respondent with respect to the earned income credit disallowance. The last of such letters stated that respondent was authorized by law to file a notice of Federal tax lien and seize petitioner's property, wages or other assets to satisfy her unpaid tax. After the receipt of the first of such collection letters petitioner informed respondent that a petition had been filed in the instant case and that further collection attempts should be terminated. Respondent's appeals office then notified his collection division to halt collection efforts pending the disposition of the instant case. Despite directions from respondent's appeals office, respondent's collection division could not stop the issuance of collection letters due to computer problems. Petitioner continued to receive computerized form letters. Petitioner was also visited by a revenue officer in connection with the collection effort.

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[3] Section 43(a), as in effect for the years in issue, provides for a credit against taxes in an amount equal to 10 percent "of so much of the earned income for the taxable year as does not exceed $5,000."

[4] Under section 43(b), the amount of the earned income credit is decreased to zero if the taxpayer's adjusted gross income is $10,000 or more. Although the parties did not explicitly so state, it appears that the adjustments made by respondent in the notice of deficiency increased petitioner's adjusted gross income for 1979 to an amount exceeding $10,000 and therefore, respondent disallowed the earned income credit claimed by petitioner.

The issues are whether petitioner should be awarded reasonable litigation costs and, if so, whether the amount of costs requested by petitioner is reasonable. Petitioner, as the moving party, has the burden of proof. Rule 232(e).

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[5] Respondent apparently relied on section 6201(a)(4), as in effect during the years at issue, which generally allows respondent to assess an amount of overstated earned income credit under section 43 without the issuance of a statutory notice of deficiency.

We first address the issue of whether petitioner should be awarded reasonable litigation costs pursuant to section 7430. Section 7430 provides for an award of reasonable litigation costs to the prevailing party of a civil proceeding against the United States provided certain conditions are met.[6] The determination of who is a prevailing party is to be made either by the Court or by agreement of the parties. Sec. 7430(c)(2)(B). An award of litigation costs is discretionary with the Court. H. Rept. 97-404 (1981) at 12. To be awarded reasonable litigation costs, petitioner must show that she has exhausted the administrative remedies available to her within the Internal Revenue Service and that she is the prevailing party. Secs. 7430(a), 7430(b). Respondent has conceded herein that petitioner has exhausted the administrative remedies available to her. What remains, therefore, is for petitioner to show that she is the prevailing

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[6] Section 7430 provides, in pertinent part:

(a) In General.--In the case of any civil proceeding which is--

(1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and

(2) brought in a court of the United States (including the Tax Court and the United States Claims Court),

the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

* * *

(c) Definitions.--For purposes of this section--

(1) Reasonable Litigation Costs.--

(A) In General.--The term "reasonable litigation costs" includes--

(i) reasonable court costs,

(ii) the reasonable expenses of expert witnesses in connection with the civil proceeding,

(iii) the reasonable cost of any study, analysis, engineering, report, test, or project which is found by the court to be necessary for the preparation of the party's case, and

(iv) reasonable fees paid or incurred for the services of attorneys in connection with the civil proceeding.

(B) Attorney's Fees.--In the case of any proceeding in the Tax Court, fees for the services of an individual (whether or not

(footnote continued)

(footnote continued from previous page)

> an attorney) who is authorized to practice before the Tax Court shall be treated as fees for the services of an attorney.
>
> (2) Prevailing Party.—
>
> (A) In General.—The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which--
>
> (i) establishes that the position of the United States in the civil proceeding was unreasonable, and
>
> (ii)(I) has substantially prevailed with respect to the amount in controversy, or
>
> (II) has substantially prevailed with respect to the most significant issue or set of issues presented.
>
> (b) Determination as to prevailing party.—Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made--
>
> (i) by the court,
>
> (ii) by agreement of the parties.
>
> * * *

party. To do so, petitioner must prove that respondent's position in the civil proceeding was unreasonable, and that she has substantially prevailed with respect to the amount in controversy or the most significant issue presented. Sec. 7430(c)(2)(A); Rule 232(e).

We first determine whether petitioner has established that respondent's position in the civil proceeding was unreasonable within the meaning of section 7430(c)(2)(A)(i). Although petitioner would have us examine respondent's conduct during the pre-petition administrative phase, his conduct after the filing of the petition, as well as his conduct with respect to the collection efforts regarding the earned income credit for 1979, we have held that the clear meaning of the statute requires us to examine the reasonableness of respondent's position during the litigation, that is to say, from the time of the filing of the petition in the case. Baker v. Commissioner, 83 T.C. 822, 827 (1984), vacated and remanded on other grounds 787 F.2d 637 (D.C. Cir. 1986). See also Wasie v. Commissioner, 86 T.C. ____ (1986). Hence, in the instant case, we only examine respondent's actions after December 15, 1983. We hold, therefore, that respondent's conduct before December 15, 1983, the day the petition was filed herein, has no bearing on our determination under section 7430.

In determining if respondent's position is unreasonable, we must take into account all the facts and circumstances surrounding the proceeding. Baker v. Commissioner, 83 T.C. at 828. Our inquiry involves a review of first, the legal basis for respondent's position and second, certain actions taken during litigation. Baker v. Commissioner, 83 T.C. at 829. Such determination should be made on the basis of the facts and legal precedents relating to the case as revealed in the record. H. Rept. 97-404 at 12. Some of the factors which might be considered are:

> (1) Whether the government used the costs and expenses of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case;
>
> (2) Whether the government pursued the litigation against the taxpayer for purposes of harassment or embarrassment, or out of political motivation; and
>
> (3) other factors as the Court finds relevant.

H. Rept. 97-404, at 12; DeVenney v. Commissioner, 85 T.C. 927 (1985).

Consistent with the foregoing, we first examine the legal basis for respondent's position in the instant case. Respondent based the proposed deficiency on the inconsistent treatment by petitioner and Mr. Wickert with respect to the same items. Section 71, as in effect during the years in issue, provides for inclusion in income by the wife of certain payments received in discharge of a legal obligation imposed on the husband by virtue of the marital or family relationship. See sec. 71(a)(1). Section 215, as in effect during the years in issue, provides a corresponding deduction to the payor spouse of such amount. See secs. 215(a); 215(b). Only payments which are "periodic payments" are within the purview of section 71. Sec. 71(a)(1);

sec. 1.71-1(d)(1), Income Tax Regs. Where the principal sum of the installment payments made to the wife is specified in the decree of divorce, such payments are ordinarily not "periodic payments" unless such principal sum is payable over a period ending more than 10 years from the date of the divorce decree. Sec. 71(c)(2); sec. 1.71-1(d)(2), Income Tax Regs. The ultimate inquiry is whether such payment was made because of the family or marital relationship in recognition of the general obligation to support made specific by the divorce decree, instrument, or agreement. Sec. 71(a); sec. 1.71-1(b)(4), Income Tax Regs.

Petitioner cited no authority for her argument that respondent's legal position in the civil proceeding was unreasonable. As support for his position, respondent relied on Schottenstein v. Commissioner, 75 T.C. 451 (1980), wherein this Court held that periodic payments made by the husband to his former wife were alimony payments notwithstanding that the payments were labeled as being made "by way of property settlement" in the separation agreement and were intended and agreed by the parties to be treated as a property settlement. Schottenstein v. Commissioner, 75 T.C. 451 (1980). We held there that the characterization of the payment is a factual question which must be resolved from the surrounding facts and circumstances and that we are not bound by the labels used in the spouses' written agreements or in the divorce decrees. Schottenstein v. Commissioner, 75 T.C. at 456 and 460. We further held that the respective property interests of the parties and the intent of the parties are important in determining if the payments were made in recognition of the general obligation to support rather than a division of property. Schottenstein v. Commissioner, 75 T.C. at 456. The principles in Schottenstein v. Commissioner, 75 T.C. 451 (1980), have been cited by this Court in subsequent cases. See, e.g., Benedict v. Commissioner, 82 T.C. 573 (1984); Jacklin v. Commissioner, 79 T.C. 340 (1982); Beard v. Commissioner, 77 T.C. 1275 (1981).

In the instant case, the payments provided in the divorce decree may be paid as late as March 1, 1989, more than ten years from February 24, 1979, the date the divorce decree was entered by the Court. Therefore, pursuant to section 71(c)(2) and section 1.71-1(d)(2), Income Tax Regs., respondent was not unreasonable in questioning the includibility of such payment in petitioner's income. Furthermore, an examination of petitioner's property interest under state law reveals that the division of property and the award of alimony upon dissolution of marriage depends on the facts of each case and the equities involved.[7] Neb. Rev. Stat. section 42-365 (1984); Lord v. Lord, 213 Neb. 557, 330 N.W.2d 492 (1983); Ragains v. Ragains, 204 Neb. 50, 281 N.W.2d 516 (1979); Steele v. Steele, 201 Neb. 549, 270 N.W.2d 903 (1978). Moreover, petitioner and Mr. Wickert were in disagreement as to the characterization of the payments, as evidenced by their inconsistent treatment thereof. Therefore, respondent could not have reasonably ascertained the intent of the parties with respect to the payments at the time petitioner filed her petition in the instant case. Respondent did no more than act to protect the revenue when faced with a "whipsaw" situation. In light of the conflicting positions taken by Mr. Wickert and petitioner, and in view of our decision in Schottenstein v. Commissioner, 75 T.C. 451 (1980), we hold that petitioner failed to prove that respondent's legal position in the civil proceeding was unreasonable.

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[7] Among the factors to be considered are the circumstances of the parties, duration of the marriage, and a history of contributions to the marriage by each party. Neb. Rev. Stat., sec. 42-365 (1984).

We now turn to respondent's actions to determine if petitioner has otherwise proved that respondent's position in the civil proceeding was unreasonable. We note at the outset that concession of a case does not mean that the conceding party's position in the civil proceeding was unreasonable. Wasie v. Commissioner, 86 T.C. ___ (1986); Baker v. Commissioner, 83 T.C. at 828.

Petitioner charges respondent with harrassment and unreasonable delay in his actions connected with conceding the only adjustment in the case. If we find that respondent's officers acted in a normal and orderly fashion, it would be inappropriate to award costs.[8] However, if they were unreasonably intransigent, then an award of costs would be warranted. Baker v. Commissioner, 787 F.2d 637 (D.C. Cir. 1986), vacating and remanding 83 T.C. 822 (1984). We may consider whether respondent used the costs and expenses of litigation to extract concessions from petitioner or pursued the litigation against petitioner for purposes of harrassment or embarrassment. H. Rept. 97-404 at 12. For the following reasons, we find that respondent's actions in connection with his concession in the instant case were not unreasonable.

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[8] See Spirtis v. Commissioner, T.C. Memo. 1985-44.

Petitioner argues that respondent was unreasonable in filing an answer in the instant case. We note, however, that it is respondent's usual practice to file an answer in a case docketed with this Court and then refer the case to his appeals office for consideration of settlement pursuant to Rev. Proc. 82-42, 1982-2 C.B. 761.[9]

That respondent indicated a willingness to concede the sole issue in the notice of deficiency as early as some two and a-half months after the petition was filed, and almost immediately after filing his answer, as evidenced by his forwarding a proposed stipulated decision to petitioner, undermines petitioner's charge of unreasonableness. Although respondent did not forward the final document reflecting his concession until nine months after his first indication of a willingness to concede, there was no indication of his ever wavering from such a posture. In fact, the only subject of dispute between the parties after February

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[9] See Spirtis v. Commissioner, supra.

1984 was petitioner's entitlement to reasonable litigation costs. The passage of time before respondent prepared the stipulation of settlement was primarily due to counsel's lack of familiarity with the relatively new procedures required by section 7430 and Rules 230 through 232. Respondent forwarded to petitioner a proposed stipulation document as early as February 23, 1984, eight days after the filing of the answer. On May 9, 1984, respondent again reiterated his intention to concede the case in a conference with petitioner's counsel.

Petitioner's reliance on the form letter of July 19, 1984, sent by respondent which stated that the file in the instant case had been sent to district counsel for preparation for trial, is misplaced. As we stated above, such letters are routinely sent by respondent to apprise taxpayers of the status of the case and do not constitute a refusal to concede. Furthermore, petitioner's failure to file a motion to continue her case from the December 17, 1984, Omaha, Nebraska trial session belies her claim of distress caused by respondent's letter of July 19, 1984.

We note that petitioner's counsel had as much right as respondent's counsel to prepare a stipulation of settlement. We can find no provision in our Rules which prevents either party from preparing such a stipulation. That respondent was acting too slowly to his liking should have prompted petitioner's counsel to draft his own version of a proposed stipulation of settlement. Petitioner could have initiated the process yet did not do so. Petitioner's counsel was not incapable of preparing such a document, however. Once respondent prepared the proposed stipulation in November, petitioner's counsel did not hesitate to substitute his own version of the stipulation therefor and thereafter a "battle of the forms" ensued.

We find that petitioner has failed to prove that through respondent's actions relating to the concession of the instant case respondent intended to extract unjustified concessions from petitioner, or that respondent pursued the litigation to harrass or embarrass petitioner. Petitioner also failed to prove that such actions otherwise constituted an unreasonable position maintained by respondent in the civil proceeding. On the contrary, the record shows that respondent had acted in a reasonable manner.

We now turn to petitioner's final argument that respondent's mailing of the collection letters after the filing of the petition constituted unreasonableness in his position and that petitioner is entitled to litigation costs thereby. Section 7430 provides for reasonable litigation costs in certain cases where the government's position "in the civil proceeding" was unreasonable. Sec. 7430(c)(2)(i). The term "civil proceeding" appears in both section 7430(a) as well as section 7430(c)(2)(i). Section 7430(a) provides that in appropriate circumstances the prevailing party in the "civil proceeding" brought in a court of the United States may be awarded attorney's fees. Section 7430(c)(2)(A)(i) provides that to be awarded costs, the prevailing party must show that the position of the United States "in the civil proceeding" was unreasonable. The language of the statute therefore establishes that it is respondent's position in the civil proceeding brought in this Court which should be the focus of our inquiry. We have interpreted such language in the statute to apply to respondent's position during the litigation only. Baker v. Commissioner, 83 T.C. at 827. The collection letters herein were issued by respondent's administrative officers and not respondent's counsel; the issuance of such letters therefore does not constitute part of the litigation and has no bearing on whether the government's position in the civil proceeding was unreasonable.

For the reasons discussed above, we hold that petitioner has failed to carry her burden of proof that respondent's position in the civil proceeding was unreasonable within the meaning of section 7430.[10] Having so held, we need not determine whether petitioner has substantially prevailed with respect to the amount in controversy or the most significant issue presented. It is also unnecessary for us to decide whether the amount of costs requested in petitioner's motion is reasonable.

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[10] We have considered Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986), remanding a Memorandum Opinion of this Court, wherein the Fifth Circuit held that the inquiry under section 7430 should focus on the Commissioner's position at the time the taxpayer's petition was filed. We find Powell v. Commissioner, supra, inapplicable herein. From the record, respondent had not acted unreasonably at the time of the filing of the petition and did not maintain an arbitrary position so as to force petitioner to file suit. On the contrary, respondent acted reasonably, especially in view of the "whipsaw" nature of the issues involved.

To reflect the foregoing,

An appropriate order and
decision will be issued.

COMPLETED
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ORIGINAL

T. C. Memo. 1986-278

UNITED STATES TAX COURT

ALVIN E. MILLER and BERNEICE M. MILLER, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 3043-84, 6775-84. Filed July 7, 1986.

Keith H. Gill, for the petitioners.

Ross W. Paulson, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: In separate statutory notices of deficiency, respondent determined deficiencies in and additions to petitioners' Federal income taxes as follows:

			Additions to Tax	
Docket No.	Year	Deficiency	Sec. 6651(a)(1)[1]	Sec. 6653(a)
6775-84	1977	$ 23,474	$ ---	$ 1,174.00
	1978	19,819	---	991.00
	1979	28,874	3,063	1,581.00
3043-84	1980	190,677	---	9,533.85
	1981	253,577	---	12,678.85

After concessions, the issues for decision are (1) whether the income from an auto product distributor business is taxable to petitioners or to the Alvin E. Miller Equity Trust; (2) whether petitioners are liable for additions to tax under section 6653(a); (3) whether petitioners are liable for an addition to tax under section 6651 for the year 1979; and (4) whether damages should be awarded to the United States under section 6673.

FINDINGS OF FACT

Petitioners were residents of Canoga Park, California, at the time they filed their petitions herein. They timely filed 1977, 1978, 1980, and 1981 Federal income tax returns with the Internal Revenue Service Center at Fresno, California. Their 1979 Federal income tax return was filed on June 18, 1980.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue.

Petitioners did not obtain an extension of time to file and had no reasonable cause for late filing of their 1979 return.

In or about 1950, petitioner Alvin Miller (petitioner) began employment as a fireman for the Los Angeles City Fire Department. In 1954, petitioners started a part-time business of selling auto care and maintenance products out of their home, with sales primarily to auto dealerships. The business was known as "Martin Distributors." In November 1975, petitioner retired from the Fire Department and began working full-time with Martin Distributors. Petitioner also attended Loyola Law School in Los Angeles for 1 year.

During 1976, petitioner purchased a preprinted package of trust documents from an organization known as the Institute of Religious Studies. On or about June 1, 1976, petitioner executed documents creating the Alvin E. Miller Equity Trust (the Trust). He executed a Declaration of Trust of This Equity Trust, consisting of nine pages of trust provisions and an acknowledgement page. The principal place of business of the Trust was designated a post office box in Woodland Hills, California. The declaration stated that "[t]rustees shall be not less than two in number, but may be increased for practical reasons beneficial to The Trust." The document further provided that

> At any regular or special meeting, a MAJORITY of the Trustees shall constitute a quorum for conducting business, PROVIDED, affirmative action may only be had upon a MAJORITY vote of the Trustees, whether present or absent, except that at special meetings called for a

> special purpose the MAJORITY present may affirmatively act in emergency matters."

Three pages of the document entitled "Trustees' Declaration of Purpose" set forth various religious beliefs of the trustor, petitioner, including the following principle:

> I subscribe to the statement of Federal District Court [sic] Judge LEARNED HAND in Halvering vs Gregor [sic], 69 Federal (2nd) 809, wherein he said:
>
>> Anyone may so arrange his affairs that his taxes shall be as low as possible; He is not bound to choose that pattern which best pays the Treasury; There is not even a patriotic duty to increase one's taxes. Over and over again courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible; everyone does it, rich and poor alike, and all do right; for nobody owes any public duty to pay more than the law demands. Taxes are an enforceable exaction, and not a voluntary contribution. [Misquotation and other errors in Trust declaration; language after the words "one's taxes" does not appear in *Helvering v. Gregory*, 69 F.2d 809, 810 (Opinion of L. Hand, Circuit Judge).]

The Trust document provided for beneficial interests, to be represented by certificates entitling "the holder thereof to a pro rata share of any distribution of income distributed by the Trustees in their sole discretion, and to a pro rata share of the Trust corpus upon the termination of the Trust."

As for the life of the Trust, the document provided:

> This Trust shall continue for a period of twenty-five years from date, unless The Trustees shall unanimously determine upon an earlier date. The Trustees may at their discretion, because of threatened depreciation in values, or other good and sufficient reason necessary

> to protect or conserve trust assets, liquidate the assets, distribute and close The Trust at any earlier date determined by them. The Trust shall be proportionately and in a pro rata manner distributed to the beneficiaries. * * *

The Trust was acknowledged by petitioner as trustor-creator, Berneice Monna Miller (Mrs. Miller) as a trustee, and Evelyn M. Fons (Fons), as a trustee. Fons was a personal friend of petitioners. The document was recorded in the County of Los Angeles on July 21, 1976.

According to Minutes of the First Meeting of the trustees of the Trust, on June 1, 1976:

> 5. * * * THE TRUSTEES of THIS TRUST received Alvin E. Miller's offer of certain of his real and personal properties listed below in accordance with applicable law and the Declaration of TRUST, for and in exchange for One Hundred (100) Units of Beneficial Interest being ALL of the Beneficial Interest of THIS TRUST; the lifetime services of Alvin E. Miller and Berneice Monna Miller and all the currently earned renumeration accruing therefrom.

The Trust and petitioner entered into an "Agreement of Services Contracts between Martin Distributors, the Alvin E. Miller Equity Trust and Alvin E. Miller," by which Martin Distributors agreed to pay 90 percent of its profits to the Trust and 10 percent to petitioner as compensation for services rendered. That Agreement further stated: "All receipts from Martin Distributors are held in joint tenancy with the Alvin E. Miller Equity Trust." According to this Agreement, "Martin Distributors is also known as the Alvin E. Miller Equity Trust" and "Martin Distributors was conveyed to the Alvin E. Miller Equity Trust on June 1, 1976."

The Minutes of the Second Meeting of the trustees, dated June 2, 1976, reflect:

> 24. That, in the best interests of THIS TRUST, The Trustees hereby nominate, unanimously elect and appoint Alvin E. Miller as THE EXECUTIVE TRUSTEE of THIS TRUST because of his business acumen in acquiring the assets he conveyed to THIS TRUST. That, in the best interests of THIS TRUST The Trustees hereby nominate, unanimously elect and appoint Berneice Monna Miller as EXECUTIVE SECRETARY OF THIS TRUST because of her knowledge and proximity to the day to day operation of THIS TRUST.
>
> * * *
>
> ARTICLE I THE DUTIES OF THE EXECUTIVE TRUSTEES SHALL BE TO:
>
> A. Manage the day to day business affairs of THIS TRUST to the best of their management ability being guided by The Trustees and the Minutes of THIS TRUST. Keep the accounts, pay the bills accruing and collect all moneys due The Trust, depositing same to the account of THIS TRUST.
>
> B. Provide for all contingencies as required by The Trustees.
>
> C. Reside in the Trust headquarters in order to best conserve and maintain the Trust's assets and supply the Trust with gardening maintenance, janitorial, and security services for the Trust headquarters. They may contract for competent assistance as needed.

Attached to those minutes was a document by which petitioners purported to assign to the Trust "[t]he right to manage, use, control or profit from" their services.

On June 2, 1976, petitioners executed:

(1) A quit claim deed by which certain real property in Hidden Hills, California, was conveyed to the Trust;

(2) A bill of sale by which other real and personal property was conveyed to the Trust, including "the exclusive use of the lifetime services of BERNEICE MONNA MILLER and all the currently earned remuneration accruing therefrom"; and personal property including savings accounts, furniture (described in great detail) and other personal property specified down to toothbrushes, towels, and Christmas decorations; and the Hidden Hills real property that was used by petitioners as their residence.

On June 2, 1976, Certificates of Beneficial Interest in the Trust were executed in a series of transactions. Petitioner was initially allocated 100 units of beneficial interest but immediately redistributed them. As a result of the transactions, petitioners held 46 units, their children held 39 units, and Fons held 15 units.

On or about June 30, 1976, Edward L. Vance (Vance), who was married to Mrs. Miller's mother, was elected as an additional trustee of the Trust. Fifteen units of beneficial interest were transferred from Mrs. Miller to Vance. Thereafter, petitioners, Vance, and Fons commenced acting as trustees. Various permits and notices were filed with State and local agencies in the name of the Trust doing business as Martin Distributors, and bank accounts were opened in the same manner. Petitioners were signatories on the banks accounts. Petitioners' automobiles and trucks were leased to the Trust for $1 per year per vehicle. None of the executed documents reflected specific transfer of inventory, accounts receivable, or other assets of Martin Distributors to the Trust.

In January 1979, Vance resigned as trustee. Fifteen units of beneficial interest were surrendered by Vance and issued to Clyde S. Pinebird (Pinebird). Vance received no payment for his interest. Pinebird was a tax return preparer who sold trust packages. Pinebird thereafter prepared income tax returns for petitioners and for the Trust. In March 1980, the Internal Revenue Service commenced an audit of petitioners' tax returns. Minutes of the Trust dated July 12, 1980, reflect the following:

> At this 8th meeting of the Trustees of this Trust held at the office the Trust, a Majority of the Trustees being present, by unanimous accord the following was affirmed and ratified, viz:
>
> Minute No. 40. The trustees of THIS TRUST have agreed to retain Jack Closson, ex-IRS Agent, as consultant to assist trustees in the IRS audit.

On or about December 10, 1980, the trustees of the Trust executed a 16-page document entitled "Amendment to Trust." Pertinent provisions of that Amendment included the following:

> Alvin E. Miller grantor and Berneice Monna Miller, Trustee; Evelyn M. Fons, Trustee; Clyde S. Pinebird, Trustee; and Alvin E. Miller, Trustee do hereby declare and announce that they intend to amend the Alvin E. Miller Equity Trust. Wherever there is conflict between the original Trust Indenture and This Amendment, this Amendment shall prevail. * * *
>
> IRREVOCABILITY
>
> This trust is declared to be irrevocable and cannot be changed in any manner by the trustor. The trustor does

not reserve or retain any dominion or control over the trust, or over the principal or income of the trust, nor any power to control the trust, to change beneficiaries, to remove or appoint other trustees, to exercise administrative powers over the trust or its property, or to revoke, modify, terminate, or change in any manner this trust instrument, or to exercise any other significant power with respect to this trust after its creation that will specifically set forth to be exercisable by the trustor within this trust instrument. The trustor has no possessory interest in the trust, no reversionary interest, and no retained interest whatsoever nor has the trustor engaged in any secret agreements or prearrangements of any type with the trustees of this trust that obligates them to act in any manner in his behalf, except as fair, unbiased, independent fiduciaries in the best interests of the beneficiaries and in strict conformity with the guidelines and requirements of this trust instrument.

* * *

NUMBER OF TRUSTEES

The Board of Trustees shall consist of at least one trustee in number, but may be increased by the trustees for any practical reason they deem beneficial to the trust.

* * *

TRUSTEE MANAGEMENT AND CONTROL OF THE TRUST

The trustees shall hold office and exercise collectively the exclusive management and control of the trust property and affairs. The property of the trust shall be held in joint tenancy. All significant actions and decisions on the part of the trust shall be made by the trustees actions unanimously.

DEPRECIATION DEDUCTION

The trust (trustees), not the beneficiaries, shall take all deductions for the depreciation of trust property.

* * *

TRUSTEE OFFICERS

The trustees may, in their discretion, elect from among their number executive trustees, which they may call by any designation or name, to carry out the supervision and day-to-day operation of the trust in behalf of the Board of Trustees and for the proper functioning of the trust. Any trustee may hold two or more positions in the trust simultaneously. The duties of such trustees shall be established in the Minutes of the Meetings of the Board of Trustees or shall be such duties as are ordinarily expected of such persons, subject to the overriding authority and restrictions upon such trustees are set forth in the body of this trust instrument.

* * *

ADVERSE PARTY

Notwithstanding any other provision in this trust instrument no power shall be exercised, nor any action taken by the trustees, except upon the unanimous consent of all trustees having authority to exercise that power and only upon the approval of an adverse party.

INDEPENDENT TRUSTEES

Each distribution, payment of income or corpus, or any other action affecting the beneficial enjoyment of the property of this trust, shall be approved and exercised only by independent trustees, that is by trustees, not including the trustor, of whom it can be said that no more than half are related or subordinate parties who are subservient to the wishes of the trustor. The phrase "unanimous action", otherwise set forth in other portions of the trust instrument, shall mean, with respect to such decisions the unanimous action of those trustees who are allowed to take part in the use of that particular power, not the unanimous action of all possible trustees.

ASCERTAINABLE STANDARDS

The trustee may accumulate for or distribute to any beneficiary such portions of the income or corpus of the trust as the trustees deem necessary for the support, care, maintenance, education, medical expenses, or emergencies of the beneficiaries. No distribution from the trust shall be made except in conformity with this external ascertainable standard.

* * *

> ### POWER TO TERMINATE THE TRUST
>
> This trust may be terminated only with the consent and approval of all the beneficiaries and parties having an interest in the trust, vested or contingent.
>
> * * *
>
> ### CONTROL OF PERSONAL SERVICES
>
> No person who is a trustee of this trust shall have any authority to, nor shall he, take part in any action or decision concerning the use or control of any personal services which he formerly conveyed to the trust. All such authority, actions and decisions shall be exercised only by the other trustees.

The Amendment was signed by petitioner, Mrs. Miller, Fons and Pinebird as trustees.

In a section headed "CONSTRUING THE TRUST INSTRUMENT" the Amendment listed 34 different provisions of the Trust Instrument to be governed by the law of one of 23 different States or by English law, even though the Trust Instrument was executed in the State of California.[2]

The Hidden Hills real property referred to in the Trust documents was petitioners' residence in 1976 and until the summer of 1977. Minutes of the Trust dated May 14, 1977, reflect the acceptance by the Trust of an offer by third parties to purchase the Hidden Hills property. Those minutes also reflect that on August 12, 1977, at the close of escrow on the Hidden Hills property, Martin Distributors would move to a new address in Canoga Park, California, which also became the residence of petitioners in 1977. On their 1977 Federal income tax return, petitioners reported and elected to defer gain on sale of the Hidden Hills residence, pursuant to section 1034. On Form 2119 attached to the return, they represented that "both the old and new properties [were] used as * * * [their] principal residence." Sale of the Hidden Hills property was never reported on any Trust return.

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[2] Although this fact initially appears to be merely a novelty, it is material in that petitioners ignore it and rely exclusively on California law in the briefs. The Amendment directs the reference to Hawaii law with respect to "declaring the trust," Maryland law with respect to "irrevocability of the trust," Illinois law with respect to personal property interest, Tennessee law with respect to "Trust purposes," Missouri law with respect to "termination of the trust," Florida law with respect to "changing the trust instrument," and sets forth other, apparently irreconcilable directions, such as application of Delaware law to "delegation of duties by trustees," Nebraska law as to "nominee functions," and English law with respect to "hiring employees of the trust." The novelty thus becomes an absurdity and undermines the bona fides of the documentation.

Meetings of the trustees reflected in minutes were consecutively numbered and occurred on June 1, 1976; June 2, 1976; July 2, 1976; August 14, 1976; March 12, 1977; May 14, 1977; January 6, 1979; July 12, 1980; December 12, 1980; May 16, 1981; May 22, 1982; August 6, 1983; October 15, 1983; January 21, 1984; June 8, 1984; July 7, 1984; and September 7, 1984. From 1977 through 1981, Fons lived in Utah and Kentucky. Pinebird participated in Trust decisions involving proposed loans of funds to petitioners' children for purchase of personal assets. Only petitioners, however, made day-to-day management decisions concerning the business of Martin Distributors.

Income of Martin Distributors was reported on Forms 1041 for the Trust for the years in issue. Petitioner's retirement income from the Los Angeles City Fire Department was reported on petitioners' joint individual income tax returns. "Administrative deductions" were taken on the Trust returns for medical and dental expenses, utilities, and other expenses relating to petitioners' residence. Payments were made by the Trust to various of petitioners' children during 1977 and reported as distributions to beneficiaries on the Trust return for that year. In 1980, payments to petitioners' children were reported as "nonemployee compensation." Petitioners' daughter, Amanda, for example, who was born May 21, 1968, was reported to have received a distribution of $300 in 1977 and "nonemployee compensation" of $3,037.44 in 1980. Their daughter Hayley, who was born November 25, 1962, was reported to have received a distribution of $1,650 in 1977 and "nonemployee compensation" of $6,760.65 in 1980. (Respondent has stipulated that the children performed services for the business.) No distributions were reported to Fons or Vance. Pinebird was paid by the Trust for his tax preparation services.

In 1981, petitioners commenced operation of a business known as Certain Sales. The income from Certain Sales was reported on the Trust return for 1981.

Respondent determined that income from Martin Distributors and Certain Sales (for 1981) was income taxable to petitioners rather than to the Trust. Respondent also determined that petitioners had income from sale of the business portion of the Hidden Hills residence in 1977. Respondent determined that certain, but not all, of the deductions claimed by the Trust were available to reduce petitioners' income during the years in issue. The parties have agreed that Martin Distributors had net profits of $51,071 in 1980 and $72,167 in 1981 and that Certain Sales had net profits of $4,404 in 1981.

OPINION

Petitioners have the burden of proving that respondent's determination is erroneous. Welch v. Helvering, 290 U.S. 111 (1933); Rockwell v. Commissioner, 512 F.2d 882 (9th Cir. 1975), affg. a Memorandum Opinion of this Court; Rule 142(a), Tax Court Rules of Practice and Procedure. Petitioners have presented no evidence with respect to the reason for the late filing of their 1979 return, and the addition to tax under section 6651(a) must therefore be sustained. Jackson v. Commissioner, 86 T.C. 492, 538 (1986).

With respect to deductions originally claimed on the Trust returns but not allowed by respondent to petitioners in the statutory notice, except to the extent that such expenses have been stipulated, petitioners presented only the testimony of petitioner as to how he allocated automobile expenses claimed on the returns and the testimony of Jack Closson as to the conduct of the audit of petitioners' returns. No substantiation as required by section 274(d) was presented with respect to disallowed travel and entertainment expenses. These items were not discussed in petitioners' opening brief or reply brief.

Thus, either petitioners have abandoned their contentions, or they have failed to satisfy their burden of proof as to these items. See Calcutt v. Commissioner, 84 T.C. 716 (1985).

The remaining dispute, therefore, is whether the business income was taxable to the petitioners or to the Trust and, if to petitioners, whether this is an appropriate case for the additions to tax for negligence or for damages under section 6673. Respondent contends that the business assets were never transferred to the Trust and that, in any event, the Trust was a grantor trust and a tax avoidance vehicle indistinguishable from those described in innumerable cases in this and other courts, e.g., Neely v. United States, 775 F.2d 1092 (9th Cir. 1985); Hanson v. Commissioner, 696 F.2d 1232 (9th Cir. 1983); Schulz v. Commissioner, 686 F.2d 490 (7th Cir. 1982), affg. a Memorandum Opinion of this Court; Vercio v. Commissioner, 73 T.C. 1246 (1980); Markosian v. Commissioner, 73 T.C. 1235 (1980); Wesenberg v. Commissioner, 69 T.C. 1005 (1978), and innumerable Memorandum opinions of this Court.

Petitioners contend that, notwithstanding the absence of specific reference to the business assets in the Trust documents, California law implements what they intended, i.e., transfer of those assets to the Trust, and that, notwithstanding the language of the Trust documents, they did not assign their income to the Trust. They claim that, notwithstanding the documentation and absence of corroborating evidence, prior to January 1, 1977, they renounced the provisions of the Trust documents dealing with assignment of income and appointment of petitioner as "Executive Trustee." They claim to have done that on the advice of an attorney by the name of Roy Ward, who was not called as a witness even though petitioner testified that Ward is still practicing law in Southern California. Petitioners contend that Evelyn Fons, Edward Vance, and Clyde Pinebird were independent trustees having an adverse beneficial interest in the Trust, and that the provisions of law dealing with grantor trusts do not, therefore, apply to this case.

Neither Mrs. Miller nor Evelyn Fons testified. Petitioner represented to the Court that Mrs. Miller was ill; Mrs. Fons was out of the country; and Mr. Vance was deceased at the time of trial. We were thus presented with the testimony of petitioner and Pinebird to contradict the documents and carry petitioners' burden of proof. The testimony was lacking in candor, uncorroborated, and unpersuasive. Disingenuous arguments made from prior to trial through the reply brief in an attempt to explain away documentary evidence reveal the weakness in petitioners' cause. For example, petitioners stipulated that Edward Vance was married to Mrs. Miller's mother, but they objected to respondent's proposed finding of fact that Vance was Mrs. Miller's stepfather. On cross-examination by respondent's counsel, petitioner denied that he was "Executive Trustee." When the Court pointed out the designation in the documents that he was Executive Trustee and asked for an explanation, petitioner, cautioned by his counsel to "keep it concise," indicated that petitioners rejected the provisions of the preprinted document "when we found out what the provisions were for making it stand," and asserted that he was "only manager of Martin Distributors."

Petitioners ask us to believe that by December 1976 they had rejected provisions of the documents executed by them in June 1976. They did not, however, do anything about changing the provisions of those documents until December 1980, after an audit of their income tax returns had commenced. As to the Amendment, in response to respondent's argument that the Amendment was so comprehensive as to negate the purported "irrevocability" of the 1976 Trust, petitioners argue in their reply brief:

> The record shows that the "amendment to trust" was signed by the Trustees and not by the Grantor of the Trust nor by the beneficiaries of the Trust and therefore has no legal significance under trust law. The record shows that the Trustees were intended merely to memorialize their initial agreement upon advice of counsel to conduct the Trust administration in accord with trust law rather than in compliance with the "printed trust."

As set forth in the Findings of Fact, the Amendment purported to be effected by the grantor and the trustees and was signed by the four trustees, including petitioner. The so-called memorialization was 4 years after the purported advice of counsel, and a few months after the commencement of an audit by the Internal Revenue Service. Without the testimony of that counsel or any documentation confirming the contents or the timing of his advice, we are unwilling to accept petitioner's testimony. We do not believe that petitioners acted in accordance with competent legal advice in forming or carrying out the Trust.

Petitioners did not during the trial attempt to explain the reporting of the sale of the Hidden Hills residence on their personal income tax return for 1977 and their election on that return to take advantage of the deferral under section 1034 of gain on sale of their principal place of residence. In their reply brief, petitioners object to a finding of fact proposed by respondent by stating:

> The Hidden Hills real property was owned and was sold by the Trustees of the Trust. Petitioners admit that they mistakenly relied upon accountant Barbara Smith in deferring gain on the sale of the Trust real property.

At trial, however, the only testimony about Barbara Smith was as follows:

> Q. Who is Barbara Smith?
>
> MR. GILL: I object to that, your Honor, on the grounds of relevancy.
>
> THE COURT: Well, when he answers this question we'll know if it's relevant or not.
>
> Please answer the question.
>
> THE WITNESS: Okay. Who is Barbara Smith? Barbara Smith was a woman accountant that the trust engaged to act only as an accountant, she was not a trustee, she gave us no -- we never contacted her during the year, she was the woman who did the accounting procedure for the Alvin E. Miller Equity Trust in 1977.

BY MR. PAULSON:

Q. Did Barbara Smith sell you your trust package?

A. No, sir. I didn't even know Barbara Smith. She was married to a fireman, but I never did know her.

Q. Who sold you your family trust package?

MR. GILL: Well, objection, your Honor. There's no evidence that anybody sold him the trust package.

BY MR. PAULSON:

Q. Did you purchase the documents to form your trust?

A. Yes, I did, from -- Yes, I did.

Q. From whom?

A. From a company in Ventura.

Q. Would that be known as the Institute of Religious Studies?

A. Yes.

Q. Is Barbara Smith the head of that institute?

A. No.

Q. Was she a salesperson for that institute?

A. She worked in an accounting capacity for, I was led to believe, several of the people who had trusts out there.

Q. Did you know if she was a salesman, or salesperson rather?

A. No. I don't know.

MR. GILL: Well, again, I would renew my objection, your Honor.

Pinebird testified that he acted as an "independent trustee." He did not identify any benefit he ever received from the "beneficial interest" he obtained when Edward Vance resigned. Pinebird identified a couple of transactions in which he refused to go along with a desire of one of petitioners' children to borrow money or purchase an automobile, and he agreed with Mrs. Miller in voting against further investment in an oil property. He participated in transactions by which the Trust borrowed money from a bank, but in that instance, he concurred with the other trustees. There was no evidence that Pinebird had anything to do with actual operation of the businesses. His testimony and petitioner's overly broad characterization of it are contradicted by the minutes showing that there were rare meetings of the trustees after Pinebird's appointment. The only reasonable conclusion from his testimony overall is that he performed services with respect to family trust packages and had no information with respect to the auto supplies business.

Petitioners claim that they renounced certain (tax disadvantaged) provisions of the form Trust documents that they executed but ask that we recognized the alleged independence of their nominal trustees. Such selective compliance, standing alone, suggests control by the grantor.

On the entire record, we conclude that petitioners have not shown that their Trust was a viable separate taxable entity operating Martin Distributors or Certain Sales. Instead we conclude that:

> The answer depends on the economic realities, the substance and not merely the form, of what was done. The courts and the Congress have long recognized that

> trusts are easily susceptible of manipulation so as to create illusion. See, e.g., Knetsch v. United States, 364 U.S. 361, 365-366 (1960); Golsen v. Commissioner, 54 T.C. 742, 756 (1970), affd. 445 F.2d 985 (10th Cir. 1971); Lazarus v. Commissioner, 58 T.C. 854, 864 (1972), affd. 513 F.2d 824 (9th Cir. 1975). "When the form of the transaction has not, in fact, altered any cognizable economic relationships, we will look through that form and apply the tax law according to the substance of the transaction. Furman v. Commissioner, 45 T.C. 360 (1966), affd. per curiam 381 F.2d 22 (5th Cir. 1967)." Markosian v. Commissioner, 73 T.C. 1235, 1241 (1980).
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> * * * [Petitioner] purported to transfer practically all of his property and the fruits of his lifetime service to the trust, * * * [Mrs. Miller, their friend, and her stepfather] immediately made him executive trustee and conferred on him virtually unlimited control over the trust property. * * * [Petitioner] purported to transfer the family residence to the trust; however, he and * * * [Mrs. Miller] continued to occupy and use the residence in the same manner as before. When they filled out their tax returns, * * * [petitioners] through the trust deducted the otherwise nondeductible personal expenses of maintaining the home. See Schulz v. Commissioner, 686 F.2d 490, 492-493 (7th Cir. 1982), affg. a Memorandum Opinion of this Court. * * *
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> * * *
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> Petitioners make much of the fact that the Declaration of Trust forbids the distribution of trust funds to the trustor or his spouse without the approval of an "adverse party trustee." They point out that the papers signed in * * * [June 1976] named * * * [Fons and Vance] and gave * * * [each 15] of the units of beneficial interest issued by the trust. In this manner, they contend that they have avoided the application of the grantor trust provisions of sections 671 through 678 and that, in this respect, * * * [the Trust] differs from the many family trusts that have been denied tax effect. On this ground, they argue that the trust must be recognized.
>
> There are several answers to petitioner's argument. Sections 671 through 678, the grantor trust provisions, are "provisions for taxing to the grantor the income of a trust over which he has retained substantial dominion and control." S. Rept. No. 1622, 83d Cong., 2d Sess. 364 (1954); Paxton v. Commissioner,

> 520 F.2d 923, 927 (9th Cir. 1975), affg. 57 T.C. 627 (1972); cf. Laganas v. Commissioner, 281 F.2d 731, 735 (1st Cir. 1960), affg. in part and revg. and remanding in part a Memorandum Opinion of this Court. Technical compliance with the formalities of those sections, however, does not preclude a decision, in an extreme case like this one, that there is such lack of economic reality as to nullify the existence of a trust for income tax purposes. S. Rept. No. 1622, 83d Cong., 2d Sess. 365 (1954); Furman v. Commissioner, 45 T.C. 360, 366 (1966), affd. per curiam 381 F.2d 22 (5th Cir. 1967). Such technical compliance with those sections does not breathe economic reality into an arrangement which causes no substantive change in the taxpayer's relationship to the trust property.
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> * * *
>
> * * * [Fons, Vance, and Pinebird were trustees in name only.] Naming * * * [them] as trustee[s] was part of the facade designed to create the illusion that * * * [petitioners] relinquished control over the trust property. * * *
>
> We conclude that the trust was a transparent tax avoidance scheme, a sham, designed to reduce * * * [petitioners'] income taxes * * * by shifting part of that income to the trust and creating deductions for personal expenses. From the record before us, we find that the trust had no economic reality or effect. * * * [Fn. ref. omitted. duBois v. Commissioner, T.C. Memo. 1986-160, slip opinion pages 13-14, 16-19.]

We have quoted the above language at length to show that this case, indeed, is no different from the innumerable cases cited above in which so-called family trusts have been found to be mere tax avoidance devices. See Neely v. Commissioner, supra.

The distortion that petitioners, and others similarly situated, attempt is comparable to their distortion of the language from Gregory v. Helvering, 293 U.S. 465 (1935), in their trust instrument quoted in the findings of fact. The truly applicable language in that case is the following:

> [T]he question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. The reasoning of the court below [the opinion of Judge Hand] in justification of a negative answer leaves little to be said.
>
> * * *
>
> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, * * * was in fact an elaborate and devious form of conveyance masquerading as a * * * [trust], and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. [293 U.S. at 469-470.]

Although the statutory provisions in question here are those dealing with the taxation of trusts as separate entities, i.e., sections 641, et seq, the concept otherwise is totally analogous.

As indicated above, we do not accept petitioner's testimony that he relied on an attorney who did not testify. We conclude that no competent lawyer could have advised petitioners that this Trust, in the manner that they operated it, would produce the desired tax advantages, and "no reasonable person would have trusted this scheme to work." See Hanson v. Commissioner, 696 F.2d at 1234. Thus we sustain the additions to tax under section 6653(a).

It is tempting to award damages in view of the groundless contentions of petitioners and our conclusion that the Trust was a sham. Because of the now conceded deductions and the extent of disputed facts, we do not award damages in this case. See Dubois v. Commissioner, supra.

Decisions will be entered
under Rule 155.

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T. C. Memo. 1986-279

UNITED STATES TAX COURT

JOSEPH PANZITTA, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21119-82. Filed July 7, 1986.

Joseph Panzitta, pro se.

Francis J. Strapp, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SWIFT, Judge: In a statutory notice of deficiency dated June 30, 1982, respondent determined deficiencies in petitioner's Federal income tax liabilities and additions to tax for the years 1974, 1975, 1976, and 1977. In an amendment to his answer herein, respondent determined increased deficiencies for 1974 and 1975. The tax deficiencies (reflecting the increased deficiencies for 1974 and 1975) and the additions to tax determined by respondent are reflected below.

Years	Deficiencies	Additions to Tax Sec. 6653(b)[1]
1974	$ 4,925	$2,462
1975	12,001	6,000
1976	10,858	5,429
1977	19,238	9,619

Respondent asserts that if the Court does not find petitioner liable for the additions to tax under section 6653(b), petitioner is liable for additions to tax under sections 6651(a)(1) and 6653(a).

Following concessions, the primary issues for decision are: (1) Whether petitioner received unreported income during the years in issue, and if so, in what amounts; and (2) whether petitioner is liable for the additions to tax under section 6653(b) or, alternatively, for the additions to tax under sections 6651(a)(1) and 6653(a).

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. At the time the petition was filed herein, petitioner was a resident of Trenton, New Jersey. During each of the years 1974 through 1977, petitioner owned and operated, as a sole proprietor, a public accounting firm. Income was earned primarily from the preparation of individual income tax returns. The business operated under the name of Joseph Panzitta and Associates. The principal place of business was in Trenton, New Jersey.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as in effect during the years in issue, and all rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner's education and his experience in the preparation of tax returns are extensive. He graduated from college and law school, and he has completed a number of professional education courses pertaining to Federal income taxes. He has been employed by a number of law firms (as a law clerk) and accounting firms. His employment experience for over 20 years has concentrated on the preparation of income tax returns, tax accounting, and bookkeeping. During the years 1964 through 1967 and 1969 through the present time, petitioner has been enrolled to practice before the Internal Revenue Service.

Although the record indicates that petitioner has rendered legal services for a number of his clients, after obtaining his law degree, petitioner never was licensed to practice law. On May 22, 1967, petitioner pled guilty to two counts of aiding and assisting in the preparation of false and fraudulent income tax returns in violation of section 7206(2), and he was suspended from practice before the Internal Revenue Service for a two-year period commencing August 17, 1967.

Petitioner's accounting firm had as many as 1,600 clients during the years in issue. The firm, however, was only marginally successful and did not make petitioner a wealthy individual.

Over the course of the years in issue, petitioner and his wife, Nancy Panzitta, maintained a total of 14 separate bank accounts with eight different banks. Five of those bank accounts were maintained in the name of Joseph Panzitta and Associates. Three were in the name of Joseph and Nancy Panzitta. Two were in the name of Joseph Panzitta. One was in the name of Nancy Panzitta. One was in the name of Elaina Corporation, and one was in the name of Management Personnel, Inc.[2]

The land and office building out of which petitioner's accounting business was operated were owned by Elaina Corporation, which was wholly owned by petitioner. Petitioner leased office space in the building owned by Elaina Corporation for his accounting business under a written lease agreement. Rental payments due Elaina Corporation under the lease were made by petitioner by checks written on one of the bank accounts in the name of Joseph Panzitta and Associates and also by endorsing checks received by petitioner from his accounting clients and depositing the checks directly into a bank account owned by Elaina Corporation.

Prior to 1977, the individuals who assisted petitioner in his accounting business were employed by petitioner doing business under the name of Joseph Panzitta and Associates. On January 11, 1977, petitioner formed a new corporation called Management Personnel, Inc., to act as employer of the individuals

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[2] The record herein does not indicate the name in which the 14th account was maintained.

(including petitioner) who worked as tax return preparers and as accountants for Joseph Panzitta and Associates. Management Personnel was wholly owned by petitioner. Similar to the method of making rental payments to Elaina Corporation, payments due Management Personnel under the employment agreement between petitioner and Management Personnel were made by checks written on one of the bank accounts in the name of Joseph Panzitta and Associates and also by petitioner's endorsement of checks received by petitioner from his accounting clients and depositing the checks directly into a bank account owned by Management Personnel.

On petitioner's and his wife's joint Federal income tax return for 1973 (a year not in issue before us), petitioner reported gross receipts from his accounting business of $42,323, deductions of $31,083 and a net profit of $11,240. That return was filed on July 2, 1975.

Petitioner did not file his Federal income tax returns for the years in issue (1974 through 1977) when due in April of each of the succeeding years. On August 16, 1976, petitioner filed documents (Forms 1040) that petitioner now claims constituted valid Federal income tax returns for himself for 1974 and 1975. At the top of the first page of each of the Forms 1040 for 1974 and 1975 petitioner typed the words "Tentative Return--Amended Return to Follow." Nominal income from miscellaneous sources was reported thereon but no income from petitioner's accounting business was reported on those 1040's for 1974 and 1975, nor were any expenses relating thereto reflected thereon. Neither of the documents contained a Schedule C (Profit or (Loss) From Business or Profession).

Petitioner also did not file timely Federal income tax returns for 1976 or 1977, and in February of 1978 respondent initiated a criminal tax investigation of petitioner. On August 11, 1978, petitioner filed Forms 1040 for himself for 1975, 1976, and 1977, on which the words, "Object: Self-Incrimination," were typed on each of the lines calling for financial information.

Respondent's criminal investigation of petitioner was terminated sometime prior to 1983 and in August of 1983, petitioner filed "amended" tax returns with respect to his Federal income tax liabilities for 1975, 1976, and 1977. On November 10, 1983, petitioner filed an "amended" tax return with respect to his Federal income tax liability for 1974. Set forth below is a comparison of the adjusted gross income from petitioner's accounting business and tax liabilities reflected on petitioner's "tentative" and his "amended" tax returns for each of the years 1974 through 1977, along with the amounts determined by respondent with respect thereto.

ADJUSTED GROSS INCOME OF PETITIONER'S ACCOUNTING BUSINESS

Year	"Tentative" Returns	"Amended" Returns	Respondent's Determinations	Petitioner Now Concedes
1974	-0-	$ 9,403	$16,076	$10,186
1975	-0-	11,073	33,623	29,968
1976	---	16,295	29,718	28,273
1977	---	21,130	45,025	29,491

PETITIONER'S FEDERAL INCOME TAX LIABILITIES

Year	"Tentative" Returns	"Amended" Returns	Respondent's Determinations
1974	-0-	$ 1,004	$ 4,925
1975	-0-	1,324	12,001
1976	---	2,406	10,858
1977	---	2,524	19,238

Throughout the course of respondent's examination of petitioner's Federal income tax liabilities, petitioner took the Fifth Amendment, could not locate records, and actively resisted respondent's efforts to obtain records from third parties. Respondent (through a canvass of local banks) eventually identified what is believed to be all of petitioner's bank accounts and obtained (via summons enforcement proceedings) copies of the relevant bank records.

A bank deposits analysis was made by respondent of the records pertaining to petitioner's banking transactions. In the stipulation of facts and during the trial herein, petitioner conceded that many of the funds deposited into the various bank accounts constituted taxable income from his accounting business. Copies of many of the deposit slips specifically identified the makers of the checks as clients of petitioner's business. Many of the checks that were identified as being written by his clients were deposited into bank accounts owned by Joseph Panzitta and Associates. Many of those checks, however, were deposited into petitioner's and his wife's personal bank accounts, or into bank accounts of petitioner's controlled corporations.

Petitioner stipulated that he did not receive any inheritances, legacies, or devises during the years 1974 through 1977, that he did not receive gifts in excess of $500 during any of those years, and that he did not have more than $1,000 cash on hand at the beginning and end of each of those years.

For 1975, 1976, and 1977, on behalf of Joseph Panzitta and Associates, and for 1977 on behalf of Management Personnel, petitioner filed employment tax returns (Forms 941). The Forms 941 for Joseph Panzitta and Associates for the first three calendar quarters of 1975, for all calendar quarters of 1976, and for the first three calendar quarters of 1977, reflected zero taxable wages paid and zero employment tax liabilities arising from petitioner's accounting business. Similarly, the Forms 941 filed on behalf of Management Personnel for the first three calendar quarters of 1977 reflected zero taxable wages paid and zero employment taxes due. For the fourth calendar quarter of 1977, the Form 941 filed on behalf of Joseph Panzitta and Associates reflected taxable wages paid of $5,962.

OPINION

Adjustments to Income

The use of the bank deposits method to reconstruct a taxpayer's income has long been sanctioned by this and other courts. See Goe v. Commissioner, 198 F.2d 851 (3d Cir. 1952), affg. a Memorandum Opinion of this Court; Estate of Mason v. Commissioner, 64 T.C. 651, 656 (1975), affd. 566 F.2d 2 (6th Cir. 1977). Bank deposits are prima facie evidence of income. Hoefle v. Commissioner, 114 F.2d 713 (6th Cir. 1940), affg. a Memorandum Opinion of this Court; Estate of Mason v. Commissioner, supra.

Under the bank deposits method, total bank deposits are computed for the years in question to determine annual gross income. Adjustments are made to total deposits to eliminate nonincome items, such as gifts, loans, redeposits, bank transfers, and amounts earned in earlier years. Finally, credit is given for ascertainable deductible expenses and exemptions. Gleckman v. United States, 80 F.2d 394 (8th Cir. 1935); United States v. Frank, 151 F. Supp. 866 (W.D. Pa. 1956). A likely taxable source for the deposits to the various bank accounts must be established (such as the fees received from petitioner's tax return preparation and accounting business). Holland v. United States, 348 U.S. 121, 138 (1954).

Where a taxpayer has not maintained adequate books and records and the Commissioner has determined that deposits to the taxpayer's bank accounts are derived from the taxpayer's income, a presumption of correctness attaches to such determination and the taxpayer has the burden of establishing that respondent's determination is erroneous. Harper v. Commissioner, 54 T.C. 1121, 1129 (1970); Estate of Mason v. Commissioner, supra at 657; Rule 142(a). Respondent is not bound to accept a taxpayer's return or his books at face value. Harper v. Commissioner, supra at 1129.

Respondent's special agents conducted an analysis of deposits made to each of the 14 bank accounts under petitioner's control. Petitioner concedes that most of the deposits constitute deposits of fees received from clients for accounting or tax return preparation services, and petitioner objects herein only to a limited number of the adjustments made by respondent in his bank deposits analysis.

Respondent, apparently, in his notices of deficiency and amendments to answer, already has treated as nontaxable deposits to petitioner's bank accounts the following items:

Year	Amount	Nature of Item
1974	$3,500	Loan from Dave Moon
1974	1,600	Refund from Cosnoski Realty
1975	3,000	Loan from Leo Harber
1976	4,000	Loan from Leo Harber
1976	2,418	Loan from Puritan Life Insurance Co.

The only amount remaining in issue as to whether its source was a loan is a $2,611 amount petitioner claims to have borrowed from Hamilton Bank in 1974 and to have deposited into his bank accounts. Although petitioner introduced into evidence a promissory note evidencing a loan of $10,611 from Hamilton Bank to Elaina Corporation dated December 13, 1974, which was signed by petitioner, he has not introduced any evidence that he actually deposited the full amount of the loan proceeds into one of the related bank accounts. Respondent's computations treat $8,000 of the bank deposits made in 1974 as attributable to that loan and therefore as nontaxable to petitioner. The relevant bank records for Elaina Corporation for 1974 reflect a deposit of $8,000 on December 16, 1974, which has been attributed to the loan in dispute. The only other deposits during the period of November 29 through December 31, 1974, to the bank account of Elaina Corporation are two unidentified deposits of $156 and $378 both on December 20, 1974. In the absence of any credible evidence that more than $8,000 of the loan proceeds in question actually were deposited to the bank accounts, we find that no further reduction to petitioner's taxable income (as derived from an analysis of petitioner's bank deposits) should be made with respect to alleged loan proceeds received from Hamilton Bank in 1974.

Petitioner also argues that $9,536 of the deposits he made to the various bank accounts in question during the period 1974 through 1977 do not represent taxable income to him because they allegedly constituted deposits of money his wife had earned or had received as gifts. Petitioner's wife did not testify herein and there is no evidence that she was employed or received gifts during the years 1974 through 1976. For 1977, the limited payroll records of Management Personnel indicate that petitioner's wife received $3,532 in net wages from Management Personnel in that year. Respondent's bank deposits analysis already has identified $2,711 of the deposits into one of the Management Personnel bank accounts in 1977 as constituting a portion of petitioner's wife's wages and therefore as nontaxable to petitioner. The balance of $821 that petitioner's wife apparently earned in 1977 from Management Personnel clearly could have been available for deposit in 1977 into one of the bank accounts used in respondent's bank deposits analysis and would not properly be taxable to petitioner. We conclude that an additional $821 of the unidentified deposits made in 1977 into petitioner's bank accounts should be treated as nontaxable to petitioner.

One last dispute between the parties[3] relating to respondent's bank deposits analysis pertains to $9,730 in cash that was deposited in 1977 into the bank account of Management Personnel. Petitioner has not offered any explanation as to the source of those cash deposits. He contends generally that all amounts deposited into the bank account of Management Personnel in 1977, if not otherwise identified and to the extent chargeable to him as taxable income under respondent's bank deposits analysis, also should be treated as offsetting, deductible expenses of his accounting business. Petitioner argues simply that all unexplained amounts deposited into the bank account of Management Personnel were used by Management Personnel to pay various expenses of Management Personnel (the business of which related solely to its business relationship with petitioner's accounting business). Thus, petitioner argues that to the extent such deposits into the bank account of Management Personnel give rise to additional income to him, they also should give rise to a deductible "subcontracting expense" of his accounting business. On the record before us we cannot conclude that all of the funds available to Management Personnel were expended for the benefit of petitioner's accounting business, and we reject petitioner's contention that he is entitled to an additional business expense deduction of $9,730 to offset that same amount of unidentified cash deposits into the bank account of Management Personnel in 1977.

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[3] Numerous other aspects of respondent's bank deposits analysis originally were in issue in this case and unagreed to at the time of trial. It is, however, our understanding that all aspects of respondent's bank deposits analysis not discussed in this opinion were conceded by either petitioner or respondent at the trial or on brief. Such concessions of the parties are to be reflected in the Rule 155 computations that the parties will make after filing of this opinion.

Petitioner has not offered any objection, explanation, or argument with respect to any remaining unagreed bank deposits that have not been specifically discussed herein and that have not been conceded by either petitioner or respondent. He has stipulated with respect to those amounts either that he "does not know the source of the deposits" or that he "has no documentation" with respect thereto. We find that the remainder of the unidentified and unagreed bank deposits (not otherwise conceded by respondent) constitute income properly taxable to petitioner.

Additions to Tax under Section 6653(b)

The next issue for decision is whether the additions to tax under section 6653(b) that have been determined by respondent should be sustained. Section 6653(b) provides an addition to tax of 50 percent of the underpayment of tax if any part of the underpayment was due to fraud. Respondent bears the burden of proving by clear and convincing evidence for each year in issue (1) that there was an underpayment of tax and (2) that some portion of the underpayment was due to fraud. Sec. 7454(a); Rule 142(b). Fraud need not be established as to the entire amount of the underpayment; rather, if any part of the underpayment was due to fraud, the section 6653(b) addition to tax attaches to the entire deficiency. Otsuki v. Commissioner, 53 T.C. 96, 105 (1969); Shaw v. Commissioner, 27 T.C. 561, 570 (1956), affd. 252 F.2d 681 (6th Cir. 1958).

The existence of fraud is a question of fact. Gajewski v. Commissioner, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978). In order to establish fraud, respondent must show that the taxpayer had the specific intent to evade a tax believed to be owed. Wilson v. Commissioner, 76 T.C. 623, 633 (1981). Direct evidence of intention rarely is available and is not necessary. Fraud is never to be imputed or presumed, however, "its proof may depend to some extent upon circumstantial evidence and may rest upon reasonable inferences properly drawn from the evidence of record." Stone v. Commissioner, 56 T.C. 213, 224 (1971).

The consistent understatement of substantial amounts of income over several years is strong evidence of fraud. Merritt v. Commissioner, 301 F.2d 484, 487 (5th Cir. 1962); Shahadi v. Commissioner, 266 F.2d 495, 501 (3d Cir. 1959), affg. 29 T.C. 1157 (1958). Any conduct, the likely effect of which would be to mislead or conceal, is indicative of fraud. Spies v. United States, 317 U.S. 492, 499 (1943). The failure to keep adequate books and records is indicative of an attempt to defraud. Agnellino v. Commissioner, 302 F.2d 797, 801 (3d Cir. 1962); Papineau v. Commissioner, 28 T.C. 54, 58 (1957).

In the context of a reconstruction of a taxpayer's income using the bank deposits method (as in the instant case), respondent must introduce evidence that the bank deposits came from currently taxable income. That obligation may be met by establishing a likely taxable source of the bank deposits or by negating all nontaxable sources. United States v. Massei, 355 U.S. 595 (1958); Holland v. United States, 348 U.S. 121 (1954).

Petitioner acknowledges that although he may have been negligent or even grossly negligent in the maintenance of his books and records, at no time did he have the intent to defraud. For the following reasons, we disagree.

Respondent has established and petitioner admits that fees from petitioner's accounting business provided the source for substantial amounts of the bank deposits that respondent has treated as taxable income. Petitioner consistently has failed to report substantial amounts of his income in each of the years involved herein. On his "tentative" tax return for 1974, petitioner reported adjusted gross income of only $661 and a tax liability of zero. On his "amended" 1974 tax return, which was not filed until November of 1983, petitioner reported adjusted gross income of $9,403 and a tax liability of $1,004. Petitioner now has stipulated herein that he had at least $10,186 in adjusted gross income for 1974, and we have found that petitioner had approximately $16,076 in adjusted gross income in 1974.

On his "tentative" tax return for 1975, petitioner reported adjusted gross income of only $1,201 and a tax liability of zero. On his "amended" tax return for 1975, petitioner reflected adjusted gross income of $11,073 and a tax liability of $1,324. Petitioner now has stipulated herein that he had at least $29,968 in adjusted gross income in 1975, and we have found that he had approximately $33,623 in adjusted gross income in that year.

Other than the "Fifth Amendment" returns, petitioner did not file on his behalf any Federal income tax returns with respect to 1976 and 1977, prior to the "amended" tax returns with respect thereto filed in August of 1983. Those tax returns indicate adjusted gross income of $16,295 and a tax liability of $2,406 for 1976 and adjusted gross income of 21,130 and a tax liability of $2,524 for 1977. As part of the trial herein, petitioner has stipulated to adjusted gross income of at least $28,273 in 1976 and $29,491 in 1977, and we have found that petitioner had adjusted gross income of approximately $29,718 in 1976 and approximately $44,204 in 1977.

Petitioner's primary explanation for his failure to file timely returns for 1974, 1975, 1976, and 1977 and for the understatements of income and tax liabilities on his "tentative" tax returns for 1974 and 1975, is that his records were misplaced due to the move of his office in early 1974. To explain his lack of cooperation in connection with respondent's audit and his interference with respondent's efforts to obtain records relating to petitioner's business from third parties, petitioner argues that he was merely asserting his Fifth Amendment rights against self-incrimination and his legal right to object to an Internal Revenue summons.

When all of the facts and evidence submitted in this case are viewed together (although quite confusing and inadequately explained in post-trial briefs filed by the parties), petitioner's arguments are not credible. Petitioner consistently ignored his obligations under the Federal tax laws to prepare and file income tax returns that reflect his true income and tax liabilities. His "tentative" returns for 1974 and 1975 made no effort to estimate his income or tax liabilities. Petitioner claims all of the records pertaining to his business were misplaced prior to 1975 and yet in July of 1975, he filed his Federal income tax return for 1973 which included substantial income and expense figures with respect to his business for that year. It thus appears his business records were relocated as of July of 1975. Furthermore, any misplacement of records for 1974 and prior years would not affect his records for 1975, 1976, and 1977.

At the trial of this case, many of petitioner's business records were introduced into evidence. No explanation was given, however, as to when they were located. Furthermore, such records are poorly organized, incomplete, and not helpful in determining petitioner's correct income.

Surely, petitioner's legal education and his employment experience as a tax return preparer and accountant gave him the understanding and knowledge necessary to maintain and to retain complete and accurate books and records as to the income and expenses of his business from which he would be able to determine his correct Federal income tax liabilities. His failure to do so has not adequately been explained and supports respondent's determinations herein.

As we have indicated, petitioner's accounting business was not particularly successful. However, significant fee income was received each year from the business. Petitioner purchased real property and a new Cadillac in 1974 or 1975. In 1977 he formed a new corporation to employ the tax return preparers he was using in his accounting business. He established numerous bank accounts, and significant fee income from his business was deposited directly into bank accounts owned by related entities, rather than into the bank accounts relating directly to his accounting business. On the facts before us, it cannot reasonably be doubted that petitioner knew his business was earning a significant amount of income on which a significant tax liability likely was due.

Petitioner's string of questionable activities relating to his and to his related companies' tax liabilities is most incriminating. We have noted the filing of a series of untimely, incomplete, and inaccurate "returns," the inadequate books and records, the numerous bank accounts, and the failure to report significant amounts of fee income over a number of years. We also note petitioner's filing of "Fifth Amendment" returns, his conviction in 1967 for the preparation of false income tax returns, and the incorrect employment tax returns filed on behalf of his accounting business and on behalf of Management Personnel.[4]

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[4] The record is clear that Joseph Panzitta and Associates in 1975 and 1976 and Management Personnel in 1977 paid wages to

(footnote continued)

We conclude that petitioner failed to report significant amounts of income earned from his accounting business in the years 1974, 1975, 1976, and 1977, and that he intentionally and willfully sought thereby to avoid the payment of his correct Federal income tax liabilities for those years. Respondent's determinations of additions to tax under section 6653(b) for each of the years 1974, 1975, 1976, and 1977 are sustained.

In light of our resolution of the above issues, other issues raised by the parties concerning the statutes of limitation and additions to tax under sections 6651(a)(1) and 6653(a) are moot.

Decision will be entered under Rule 155.

(footnote continued from previous page)
employees during the calendar quarters. Except for the fourth quarters of 1975 and 1976, those two businesses filed employment tax returns reflecting zero taxable wages paid and zero employment tax liabilities due.

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UNITED STATES TAX COURT

JOHN D. MILLER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 20906-82. Filed July 7, 1986.

John D. Miller, pro se.

Christy M. Pendley, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILBUR, *Judge*: Respondent determined the following deficiencies in, and additions to, petitioner's Federal income taxes for the years in issue:

		Additions to Tax	
Year	Deficiency	Sec. 6653(b)[1]	Sec. 6654
1976	$ 5,921.00	$2,960.50	$158.18
1977	6,508.01	3,254.01	232.49
1978	8,576.80	4,288.40	46.96
1979	8,952.73	4,476.37	55.57
1980	10,465.46	5,232,73	128.35

The issues for decision are:

(1) Whether petitioner received unreported income during each of the years in issue.

(2) Whether petitioner is liable for the addition to tax for fraud pursuant to section 6653(b) for each year.

(3) Whether petitioner is liable for the section 6654 addition to tax for failure to pay estimated tax for each year.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by this reference.

John D. Miller (hereinafter petitioner) resided in Altoona, Iowa at the time he filed his petition in this case. Petitioner failed to file Federal income tax returns for any of the years in issue. He filed joint Federal income tax returns with his wife Betty for the years 1972, 1973, and 1974. Petitioner was convicted on April 30, 1980 of willful failure to file a Federal income tax return for each of the years 1976 and 1977 pursuant to section 7203.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue.

During all of the five years in issue, petitioner worked as a truck driver for J.I. Case Company. During the taxable years 1976, 1977, 1978, 1979, and 1980, he received wages from his employer totaling $23,968.36, $24,802.90, $27,513.61, $29,191.27, and $32,160.11, respectively. In addition, during the years 1976 and 1977 petitioner received $72.24 and $80.52 from the Case Employees' Credit Union.

On January 29, 1976, petitioner filed a Form W-4E, Exemption From Withholding, with his employer claiming that he incurred no Federal income tax liability for the year 1975 and anticipated no tax liability for the year 1976. On April 25, 1977 petitioner filed a second Form W-4E claiming that he had incurred no tax liabiity for the taxable year 1976 and that he expected no tax liability for 1977. On August 14, 1978 Mr. Miller filed a Form W-4, Employee's Withholding Allowance Certificate, claiming that he incurred no Federal tax liability for 1977 and that he anticipated no such tax liability for 1978.

OPINION

1. Deficiencies for 1976 through 1980

The first issue is whether there are deficiencies in Federal income taxes due from petitioner in the amounts determined by respondent for the years 1976 through 1980. Petitioner has not argued that he did not receive wages in the amounts determined by respondent. Rather, he argues, inter alia, that he is not a "person" for purposes of the Internal Revenue Code and is therefore not required to pay taxes or file returns. This argument as well as the taxpayer's other tax protest contentions are totally unmeritorious and are not deserving of our further discussion. See Rowlee v. Commissioner, 80 T.C. 1111 (1983).

Respondent's determination of the deficiencies is presumptively correct. Rule 142(a)[2]; Welch v. Helvering, 290 U.S. 111, 115 (1933). Petitioner has offered no evidence to overcome this presumption. Accordingly, we sustain the deficiencies determined by respondent for the five years in issue.

2. Section 6653(b) Addition to Tax

We next consider whether petitioner is liable for the addition to tax for fraud pursuant to section 6653(b) for each of the years 1976 through 1980.[3]

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[2] Unless otherwise indicated, all rule references are to the Tax Court Rules of Practice and Procedure.

[3] Sec. 6653(b) provides as follows:

> (b) FRAUD.--If any part of any underpayment * * * of tax * * * is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a) * * * [relating to negligence or intentional disregard of the rules and regulations regarding the payment of income or gift taxes.]

Petitioner was employed as a truck driver for J.I. Case and earned income in excess of $20,000 for each of the years involved in this case. He filed joint Federal income tax returns for the years 1972, 1973, and 1974 but failed to file returns during the years 1976 through 1980. He was convicted criminally on April 30, 1980 of willful failure to file income tax returns for the years 1976 and 1977 pursuant to section 7203.

In 1978, petitioner's spurious tax protestor arguments brought him before this Court. On that occasion, we granted respondent's motion for summary judgment and rejected petitioner's claims that Federal Reserve Notes are not dollars, that the income tax is unconstitutional and that the Tax Court is an illegal usurpation of judicial power by the legislative branch.

In addition to refusing to file Federal income tax returns for the years in issue, petitioner filed a false Form W-4E with his employer on January 29, 1976 claiming that he incurred no tax liability for the taxable year 1975 and anticipated no tax liability for 1976. On April 25, 1977, he filed a false Form W-4E claiming that he incurred no tax liability for the year 1976 and expected no liability for the taxable year 1977, and on August 14, 1978, he filed a false Form W-4 with his employer claiming that he incurred no tax liability for 1977 and anticipated no tax liability for 1978. Attached to these W-4E and W-4 Forms were documents containing various tax protestor arguments all of which are totally without merit. See United

States v. Daly, 481 F.2d 28 (8th Cir. 1973); Hatfield v. Commissioner, 68 T.C. 895 (1977); Gajewski v. Commissioner, 67 T.C. 181 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978); Cupp v. Commissioner, 65 T.C. 68 (1975), affd. by order 559 F.2d 1207 (3d Cir. 1977).

Respondent determined that petitioner had unreported wages in an amount that exceeded the minimum amounts set forth in section 6012.[4] In addition, petitioner has refused to provide this Court with any evidence concerning his failure to file tax returns or pay the tax owing for each of the years in issue. His primary argument at trial and on brief is that he is not liable for the payment of Federal income taxes because he is not a "person" for purposes of the Internal Revenue Code. This argument as well as the other arguments made by petitioner have been rejected repeatedly by this Court and others and are undeserving of further comment. See, e.g., Rowlee v. Commissioner, 80 T.C. 1111 (1983).[5]

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[4] Sec. 6012 provides, in pertinent part, as follows:

> (a) General Rule.--Returns with respect to income taxes under subtitle A shall be made by the following:
>
> > (1)(A) Every individual having for the taxable year the gross income of $1,000 * * * or more * * *.

[5] See also Hodge v. Commissioner, T.C. Memo. 1984-109.

Respondent contends that petitioner's actions during the years in issue constitute fraud, and that he is liable for the addition to tax under section 6653(b). We agree.

Whether a taxpayer acted fraudulently must be determined on the basis of all the facts and circumstances. Stratton v. Commissioner, 54 T.C. 255, 284 (1970). Respondent has the burden of proving by clear and convincing evidence that some underpayment exists and that part of the underpayment in each year was due to fraud. Section 7454(a); Rule 142(b).[6] This burden is satisfied if it is shown that the taxpayer "intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes." Rowlee v. Commissioner, supra at 1123; Stoltzfus v. United States, 398 F.2d 1002 (3d Cir. 1968). The existence of fraud is a question of fact to be gleaned from a consideration of the entire record. Gajewski v. Commissioner, supra. Fraud will never be presumed. Beaver v. Commissioner, 55 T.C. 85, 92 (1970). The fraudulent intent, however, may be proven by circumstantial evidence emanating from the taxpayer's entire course of conduct. Rowlee v. Commissioner, supra at 1123; Stone v. Commissioner, 56 T.C. 213, 223-224 (1971).

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[6] Sec. 6653(c)(1) defines "underpayment" for purposes of sec. 6653 as a "deficiency" as defined in sec. 6211, except that the tax shown on a return referred to in sec. 6211(a)(1)(A) shall be taken into account only if the return was timely filed.

Petitioner admits that he received wages in the amounts determined by respondent during the years in issue. This fact in conjunction with his failure to report those amounts constitutes clear and convincing evidence of the existence of an underpayment during each of the years in issue.

Petitioner failed to file an income tax return for the taxable years in question. On April 30, 1980, he was convicted criminally of a willful failure to file returns for the taxable years 1976 and 1977 in violation of section 7203. We note that the intent to evade taxes is not an element of the criminal offense charged under section 7203. That crime is complete with the willful failure to pay a tax, file a return, maintain records, or supply information. Thus, a conviction under section 7203 does not establish, as a matter of law, that petitioner failed to file a return with an intent, or in an attempt, to evade taxes. Wright v. Commissioner, 84 T.C. 636, 643 (1985). However, it is well established that while a failure to file an income tax return is not, standing alone, proof of fraud on the part of the taxpayer, Kotmair v. Commissioner, 86 T.C.___ (June 19, 1986), such failure is evidence that may be considered as indicative of fraud. Rowlee v. Commissioner, supra at 1123. Based on the record as a whole, it is clear that petitioner's purpose in failing to file returns was to evade, and not merely to delay, the payment of taxes that he argues he was not obligated to pay. In these circumstances we think petitioner's failure to file should properly be viewed as conduct intended to conceal his noncompliance with the law. Here there is the additional fact that petitioner evaded payment of his income taxes through the filing of false W-4E and W-4 certificates for three of the years in issue. The filing of a false withholding certificate is evidence of fraud. Rowlee v. Commissioner, supra at 1125; Stephenson v. Commissioner, 79 T.C. 995, 1007 (1982), affd. 748 F.2d 331 (6th Cir. 1984); Habersham-Bey v. Commissioner, 78 T.C. 304, 313-314 (1982). "Notwithstanding his purported belief that he was exempt from tax, this type of self-help is unexcused and essentially inexcusable." Rowlee v. Commissioner, supra at 1125.

In summary, petitioner's filing of joint income tax returns for the years 1972, 1973, and 1974 clearly established that he knew of his obligation to report his income and to pay tax thereon. His claim that he is exempt from the obligation to pay tax is without merit. We view petitioner's failure to file returns during the years in issue as an attempt to conceal his obstinacy and not a bona fide challenge to the validity of the tax laws he now claims are unconstitutional or unfair. His filing of false withholding certificates provides "additional affirmative indications of his motivation" to evade the payment of taxes. Rowlee v. Commissioner, supra at 1126. Although there is no evidence that petitioner filed false withholding certificates for 1979 and 1980, we nonetheless regard his failure to file tax returns for those years, in combination with the pattern of substantial underreporting of income that was present throughout all five years, as sufficient to establish the requisite fraudulent intent for such years as well. Otsuki v. Commissioner, 53 T.C. 96, 108 (1969).

We are convinced that the evidence as a whole clearly establishes that petitioner knew of his obligation to file returns and pay taxes, and that he attempted to evade his responsibilities during each of the years in issue. Petitioner's freedom to express his political beliefs simply does not carry with it a right to defraud the United States Government. Accordingly, we find and hold that respondent has established fraud by clear and convincing evidence. Petitioner is therefore liable for the section 6653(b) addition to tax for each of the years in issue.

3. Section 6654 Addition to Tax

Section 6654 imposes an addition to tax for underpayment of estimated tax where there has been a failure to pay or an underpayment of estimated tax. This addition to tax is mandatory and no inquiry is made as to reasonable cause or lack of willful neglect. Bagur v. Commissioner, 66 T.C. 817, 824 (1976). Petitioner offered no evidence to show that respondent erred in determining that additions to tax should be imposed under section 6654. Accordingly, we sustain respondent's determination with respect to this issue.

Decision will be entered
for the respondent.